ECONOMIC STUDIES IN ENGLISH

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Contents

Preface

This book is very important for the students in the field of economics. It presents the students with the basic terminology and concepts of this field as a preparation for in-depth and specialized studies in their educational career. It introduces the definition, scope and intended objectives of economics. In addition, it sheds light on the recent basic models and applications of economics.

The book consists of 15 chapters in the field of micro- and macro-economics that cover the following topics: the Economic Problem, Demand and Supply, Elasticity, Production and Cost Theory, Market Theory, Distribution Theory, Money Theory, National Product and Income, Inflation and Unemployment, Official Budget, International Trade, and Economic Development. The following considerations are observed in order to understand the contents of this book:

- Simplicity of presentation to suit the beginners in the field.
- The bilingual English-Arabic glossary in Chapter 15 which presents expressions and terms to help students in interactive studies and practice using the two languages.
- Questions are provided for student review.

We hope that the book will be of benefit for students and instructors and we welcome any advice or suggestion for improvements.

Cairo in August 2005

The Author
Ezzat Kenawy

CHAPTER 1

Economics : Definition and Scope

1 – 1 . Introduction

Economics is concerned with the creation and of distribution wealth in which people have roles as both producers and consumers. As resources are scarce and our wants are unlimited choices have to be made. The alternatives forgone in these choices are known as opportunity costs. In order to make the most efficient use of scarce resources various production decisions have to be made, such as what, where, how and for whom to produce.

In solving these problems specialization and exchange by both individuals and countries are involved. Effective resorce utilization means interdependence and shows efficiency.

1 – 2 . The Nature of an Economy

An economy consists of interaction among all the means by which goods and services are provided and traded at any time and place. It consists of the specialization of labor, financial institutions, assembly lines, factories, mines, labor saving devices, markets and whatever goes into the production and

distribution of goods. It could embrace the whole world, or it could be, as it sometimes has been, restricted to a small isolated community of people who have no relations with the rest of the world.

1 – 3 . What is the definition of Economy?

The formal definition of Economy would be: Economy is the careful use of land, labor, and capital (e.g., resources, energy and ingenuity, and productive devices) to realize the greatest return of goods and services from them. It is simply the means by which humans efficiently supply their wants.

Your study of economics should make your private decisions more effective, and your views on social issues more balanced. Economics has been called "the dismal science" because economists are always telling people what is wrong with superficially attractive solutions to social problems.

Mr. A would like to ease his financial burdens by drastic cuts in taxes. The economist tells him that he must then consider poor public schools for his children, or curtail public library and play gound house.

Mrs. B would cure unemployment at home by banning the import of cheap foreign goods. The economist tells her that our export industries depend on sales to these same foreigners and

we'd clearly all be worse off if countries could not spcialize in the Production of goods.

Mr. C would eliminate poverty by guaranteeing a high income to all. The economist tells him that this would gravely weaken the incentive to work and that we can not in aggregate consume what we do not produce.

The economist might personally favor any or all of these proposals, but emphasizes that they all have costs that must be weighed against their actual or seeming benefits unfortunately, when People become more committed to policies they generally don't what to hear of possible disadvantages.

1 – 4 . Why is Economy important?

The necessity of economy arises from the nature of humans and the conditions of life on planet Earth. "Humans' Wants Exceed Their Means".

Humans' wants are such that there is no way they can be completely filled by goods and services. Humans' wants are limited only by their imagination, which is another way of saying that they are infinite. But the means of supplying them are certainly limited.

They are limited by the available resources, limited because the supply of energy and ingenuity is limited, limited because

productive devices are in short supply. Human wants are then infinite, and the means of supplying them are scarce. Economy is the means for supplying the most pressing wants by careful employment of the elements that go into providing for them.

The practice of economy is normal for human.

They tend to be economical, to spend as little as they can to gain as much as they can of what they want. To these ends, they save, conserve, and invent all sorts of ways to increase their supply of goods and services more efficiently.

1 – 5 . Microeconomics and Macroeconomics

Microeconomics is the study of the decisions of people and businesses and the interaction of these decisions in markets. The goal of microeconomics is to explain the prices and quantities of individual goods and services. Microeconomics also studies the effects of government regulation and taxes on the prices and quantities of individual goods and services.

For example. Microeconomics studies the forces that determine the prices of cars and the quantities of cares produced and sold. It also studies the effects of regulations and taxes on the prices and quantities of cars.

Macroeconomics is supposed to deal with economy at the level of nations. Marc-economics deals in terms of such indices as

gross national product (GNP), national income, employment and unemployment figures, wholesale price index, and so forth. These and other such indices are supposed to tell us how well "the economy" is performing.

Macroeconomics also studies the effects of government actions taxes. Spending and the deficit on total jobs and incomes.

For example macroeconomics studies the forces that determine the average cost of living in European countries, the total value of each country's production and the effects of government budget policy on these variables.

Although microeconomics and macroeconomics have their own separate focus. They use a commonest of totals and ideas. Some problems have both a microeconomic and macroeconomic dimension.

An example is the invention of video games and the growth of the market in multimedia products. Microeconomics seeks to explain the prices and quantities of games, while macroeconomics explains the effects on the total amount of spending and jobs in the economy as a whole.

1 – 6 . Economic Systems

It is important to know that there are various economic systems. There is a free economy, a planned economy, a controlled economy, a capitalist economy, a socialist economy, and a mixed economy.

A – Free-Market Economy/Capitalism

Is an economic system in which the allocation of resources is determined solely by supply and demand in free markets, though in practice there are some limitations on market freedoms in all countries.

Free-market economy is usually used as synonymous with capitalism, which is a social and economic system in which individuals are free to own the means of production and maximize profits and in which resource allocation is determined by the price system.

B – Planned Economy

The economic system in which both the production and distribution of the wealth of a country are entirely controlled by he government.

This is a form of economy in which (most) resources are allocated centrally by government, rather than by markets.

All land and capital resources in such an economy are owned by the state, and factories are given resources to reach specified

targets. The distribution of income is likewise determined centrally.

C – Mixed economy

An economy that has both a predominant private sector and a sizeable public sector, so that resources are allocated both the market and by the state.

In the private sector, the market or price system will determine what quantities of goods and services are produced, and to whom they are distributed. In the public sector, such decisions will be made by government. The economics of all modern states except the communist planned economies are mixed.

The relative importance of the two sectors varies. During the 1980s many countries favored privatization and deregulation of public-sector enterprises. In a mixed economy, there may also be some government intervention in private-sector economic activity.

1 – 7 . Public versus Private Sector

A – Public sector

The part of the economy under direct national or local government control. On the production side, it comprises public services, such as nationalized industries, and public (State-owned) corporations.

On the spending side, government expenditure includes government outlays on goods and services together with transfer payments, such as pensions and social security payments. Some of the outlays are on what economic theory calls public or collective goods, that is goods whose consumption by one individual does not preclude consumption by others, such as street lighting and national defense. The public sector is financed by taxation.

B – Private Sector

The part of an economy that is not under government control.

- **Deregulation**

The removal of controls imposed by governments on the operation of markets. Many economists and politicians believe that during this century governments have imposed controls over markets that have little or no justification.

- **Privatization**

The process of selling a publicly owned company to the private sector. Privatization may be pursued for political as well as economic reasons.

The economic justification for privatization is that a company will be more efficient as a result of competition. The process can also be called denationalization.

CHAPTER 2

The Economic problem

2 – 1 . The economic problem: needs and wants

a) Your needs: those things you think are necessary for living.

b) Your wants : things you would like to be able to do.

Example: on you needs list you will probably have food, water, clothes and shelter. Clean water, and on your wants list you.
On the other hand you might want to buy and own a house in Marina or a Mercedes car in your garage.

Make a list of your needs and wants

To limit the time spent on this activity you should only put 25 items on your wants list! What do you notice about your lists? You will probably find that the really important items are on the NEEDS list – water, clothing, warmth and protection, food and some form of housing or shelter. And on your WANTS list? That will be up to you and your interests and tastes, but you could probably have written a very long list indeed.

Do you already own all of the items on your wants list – if you do then you must be very lucky and very rich! Most people in the world cannot afford to buy everything they want because

our wants are unlimited. In many countries, some people cannot afford to buy the things they need and they are likely to be very poor.

Why are there so many wants and needs that we cannot satisfy? Why are millions of people living in poverty in many countries around the world? Most people will answer these questions by saying, 'Because there is not enough money'.

Is this the real ECONOMIC PROBLEM – shortage of money? An example may help to show you why more money is not the answer to the problems of being unable to satisfy all people's wants and needs.

2 – 2 . The real cause of the economic problem

The real cause of the shortage of goods and services in a country is not having too little money. It is too few FACTIRS OF PRODUCTION (also called resources of production). There are four factors of production.

- Land This term is used to cover all of the natural resources provided by nature and includes fields and forests, oil, gas, metals and other mineral resources.
- Labor This is the efforts of people needed to make products.
- Capital This is the finance, machinery and equipment needed for the manufacture of goods.

❖ Enterprise This is the skill and risk-taking ability of the person who brings the other resources together to produce a good or service. For example, the owner of a business. These people are called entrepreneurs.

In any one country, and in the world as a whole, these factors of production are limited in supply. As there is never enough land, labor, capital or enterprise to produce all of the needs and unlimited wants of a whole population, there is an economic problem of SCARCITY.

Unlimited Wants + Limited resources = Scarcity

2 – 3 . Limited resources: the need to choose

We make choices every day. We have to because, as we have seen, not all of our wants can be met. Therefore we have to decide which wants we will satisfy and which we will not.

Should I take a bus to college or use the money to buy some more paper for my Business Studies notes? Do I buy a new coat or spend the money on a new radio? All choices involve giving something up.

This problem exists for governments and businesses as well as for individuals. Should the government build another hospital, or a new road into the city? Should the owner of a business purchase a computer or use the resources to pay for a new advertising campaign?

All of these choices involve giving up something too. If the resources or the factors of production were not scarce, there would be no need to choose. We could all have everything we wanted! In making any choice, we need to consider what we are giving up, to make sure it is not worth more to us than the option we are choosing. This is called considering the Opportunity Cost of a decision – the lost opportunity resulting from the choice of something else.

2 – 4 . The economic Problem Questions

In theory the basic economic problem is how to use the available resources in a community to meet the existing needs of society. The resources are usually limited (or finite).

All countries have land, raw material, people and capital but their quality and quantity very significantly. For instance, Britain has insufficient land (245,000 sq km) to meet its food needs but a large and enterprising population (56 million).

In contrast Tanzania has a plentiful supply of land (945,000 sq km) but a relatively small population (16 million). However, Tanzania's average income per head is LE 155 and Britain's is LE5520.

On the other hand, needs and wants are infinite (unlimited). The basic needs of food, clothing and shelter are fulfilled for most people living in the developed countries of the world. With

the improvements in the standard of living people's demands and expectations have accelerated, e.g. families want two of most luxuries (color TV) instead of one, so wants are outstripping needs.

In underdeveloped countries basic needs are often rarely met, although occasionally the luxurious wants of the rich few are satisfied, e.g. expensive racehorse purchases of Arab oil sheiks. The GDP per capita of Tanzania indicates that its capacity to produce goods and services is very restricted and thus the average standard of living is low.

As all wants cannot be met, choices have to be made in allocating the resources. In making these choices, decisions about production have to be made:

- foı whom to produce?
- what to produce?
- where to produce?
- How to produce?
- When to produce?

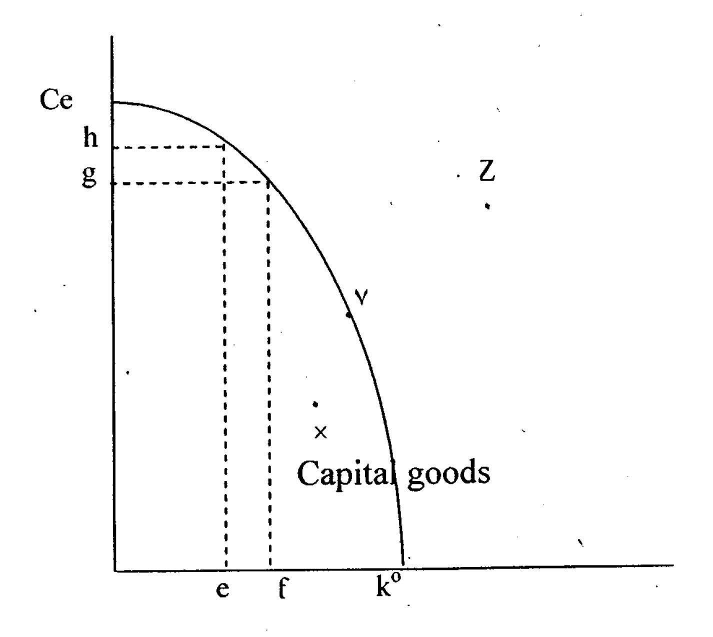
1. **What goods and services will be produced** and in what quantities ? Will more cable companies offer pay-view service or will more multiplex cinemas be built ?
   Will young professionals take more exotic holidays or live in larger houses?

2. **How will various goods and services be produced**? Will small
   Supermarkets operate with three checkouts and cashiers using laser scanners, or with six check – outs and cashiers keying in prices by hand? Will care factory workers weld by hand or will robots do the job? Will credit card companies use computers or clerks to read payment slips?
3. **When will the various goods** and services be produced ? Will a Supermarket operate 24 hours a day for 7 days a week or just 10 hours a day for 6 days a week ? Will a car factory close for the summer and day off workers ? Will there be a surge of house building in the spring bringing higher wages and longer for construction workers ?
4. **Where will the various goods** and services be produced ? Will Barclaycard process its change slips and accounts in the United Kingdom. Or will it here less costly labor in India and transfer its records by satellite/ Will airline keep its headquarters in Belgium or move to Luxembourg where employment costs are lower? Will lower UK wage costs attract more companies or will they move to other European countries to gain higher productivity?
5. **Who will consume the various goods** and services? The distribution of economic benefits depend on the

distribution of income. People with high incomes are able to consume more goods and services than people with low incomes. Who gets to consume what depends on income. Will the ski instructor consume more than the lawer's secretary ? Will the people of Europe consume more than the people of Ethiopia?

2 – 5 . Production possibility curves

These show how one commodity (commodity A) can be transformed into another commodity (commodity B) by reducing output of commodity A and transferring the resources released into the production of commodity B, or vice versa. They therefore show all those possible combinations of the two types of commodity and are drawn on the assumption that resources in the economy are fixed in total. Consider the following diagram.



If all resources are devoted to the production of consumer goods then c consumer goods will be produced but no capital goods. If all resources are devoted to the production of capital goods then K capital goods will be produced but no consumer goods. Any combination of consumer and capital goods is

possible along the production possibility curve C – K eg point Y. Point X indicates a combination of capital and consumer goods where all resources are not employed Point Z is not technically possible given present resources and technology.

The production possibility curve also illustrates opportunity costs because an increase in production of consumer goods implies less production of capital goods, i.e., there is an alternative forgone. The shape of the production possibility curve illustrates diminishing returns because as more and more consumer goods are produced then small additions in consumer goods are gained at the cost of larger amounts of forgone capital goods.

This indicates that the resources being transferred into consumer goods are not as efficient (productive) as early resources used. For example, to gain (hg) consumer goods implies a loss of (ef) capital goods.

2 – 6 . Specialization and the division of labor

Abdel Rehim amr is using the principles of SPECIALISATION AND DIVISION OF LABOR. By dividing up the different jobs and making each worker a specialist in one of these, output is increased. By concentrating on what each worker is best at and avoiding time wasting from moving people from one stage of

production to another, total output and productivity (output per worker) are increased.

Also, Jack is using specialization between firms by using timber firms to provide him with materials, and transport and retail firms to sell and distribute the goods to the customers. A chain of production has now been created using several firms to supply the product from its natural state (timber0 to the final consumer. Specialization does have great benefits, but there could be drawbacks too. Workers may become bored by concentrating on only one stage of production. The firm is now relaying on outside suppliers and retailers and these could prove to be unreliable.

Throughout the industry, the division of labor operates with different workers working separately and each producing something which contributes to the production of the final product.

Advantages to a firm of the division of labor

1. Perfect practice: the repetition of a task improves worker experience.
2. Increase of output: as more is produced per man.
3. Savings in training: and time because workers need less instruction if they are only performing part of a job or operating just one machine.

4. Tools/equipment: each worker does not need to complete set of tools because he is only performing part of the output.
5. Machinery can be used more often. Such mechanization leads to faster and cheaper output.
6. Efficiency: will probably be increased if piece rate can be used to reward workers.

Disadvantages to a firm

1. Absence, faults, strike may stop by the worker(s) may stop the whole production process.
2. Specializing in a single task causes job dissatisfaction and alienation from their coworkers.

2 – 7 . Why is business activity needed ?

We have identified the following issues.

- People have unlimited wants.
- The four factors of production – the resources needed to make goods are in limited supply.
- Scarcity results from limited resources and unlimited wants.
- Choice is necessary when resources are scarce. This leads to opportunity cost.
- Specialization improves the efficiency with which resources are used.

The aim of all business is to combine the factors of production to make products which will satisfy people's wants. These products can either be goods – physical items such as cars and shoes which we can touch and see or they can be services, such as insurance, tourism or banking.

Businesses can be small – just one person, for example – or large. Some businesses employ thousands of people with operations in many different countries. Businesses can be privately owned or owned by the state.

2-8 . Decision makers and the Circular Flow of activity

That there is an economic system that there are laws of economics is the first message to learn. We can now survey some of the necessary elements going into the make-up of the economic system.

Economics concerns the making of rational decisions, as well as the social interactions of the choices so made. What are the active entities to be regarded as engaging in the process of choice? We shall deal in this chapter with three main categories of decision-making units: individuals, firms, and governments.

Individuals are the ultimate active members of social systems, the only agents said to have goals or preferences and to engage in the process of consumption Actually, recognizing the mutual support and cohesiveness of the family some economists prefer

to consider the "house-hold" to be the effective consumptive unit. Except where otherwise specified, the individual her will be understood as making decisions for his or her family or house-hold.

The business firm is an artificial unit; it is ultimately owned by or operated for the benefit of one or more individuals. Surprisingly, this fact is often not appreciated. It is sometimes argued, for example, that "soulless corporations" can be taxed without cost to the people. But of course taxing a corporation will hurt some people: the company's owners will suffer reduced profits, its workers may find it harder to get wage increases, and its customers are likely to find that prices of its products have been increase. (At the same time, the taxes paid will allow government to provide assistance to other people- as usual; every choice of policy involves both costs and benefits.)

The economist finds it convenient to think of firms as distinct agent specialized in the process of production, the conversion of resource inputs into desired goods as outputs. In point of fact, however, much production actually takes place within the household; cooking, gardening, and home maintenance are examples.

Individuals and firms are not the only economic decision-making agents. A third category, government, is of great and

growing importance. Governments, like firms, are artificial groupings; they differ from firms by not being owned by individuals, and also by having powers to take property involuntarily, yet legally (as by taxing).

From the economic point of view governments are agencies engaging in a number of collective productive and consumptive activities, the scope of which is determined by a political rather than a market process.

Perhaps even more important, government establishes the legal framework within which entire economy works. Just as ownership of valuable resources (economic power) leads some individuals to superior outcomes through the market mechanism, similarly possession of influence over government policies (political power) can be expected to lead others to superior outcomes through the political mechanism.

In complex modern economies there are still other "collective" decision-making units, in which people get together for undertaking some form of united action. Trade unions and cartels are of particular interest as representing organizations of buyers or sellers in markets.

Of lesser economic importance are voluntary associations like clubs, foundations, and religious institutions, which can be

regarded as instrumentalities whereby individuals combine for certain collective consumptions choices.

The all-pervasive economic problem is that of scarcity. Not all desired things are available to individuals, the ultimate decision-making agents. When and as desired.

Even if all desired physical commodities were present in unlimited quantities, We would not have enough time to enjoy them all. And, in addition, We all desire things other than material commodities; power, love, prestige. Ther can never be enough of these.

It is the fact of scarcity that forces us to make economic decisions, that is, to organize our efforts for production and/or to engage in trade with a view toward obtaining desired objects.

Setting aside the desire for social relations and distinctions like affection or prestige, which we will not attempt to cover in this chapter, the entities that we usually think of as the objects of economic choice are called commodities, or goods and services. Goods as distinguished from services are physical things (wares, or merchandise):

Services represent a flow of benefits over a period of time, derived either from physical goods (like the shelter service provided by a house) or form human activities (like the entertainment service provided by concert performers). For the

present, therefore , we will think of commodities or goods as synonymous words covering also desired consumption services.

Consumption of commodities or goods represents one of the main economic activities.

The consumptive decisions of particular individuals will range over the various goods available, attempting to pick out assortments within their means that best accord with their given tastes. We shall say that goods are the objects of choice for the consumption decision.

Production is anther main economic activity. We shall sometime find it convenient to regard it as engaged in by individuals, and sometimes by firms. We usually think of production as the physical conversion of inputs into outputs, i.e., of resources (or the services of resources) into consumable goods.

More fundamentally, production is any transformation adding to the social totals of some desired goods at the expense of a reduction in the amount of other. Production might represent a transformation of physical form, as in the conversion of a leather and human labor into shoes, but not necessarily so transformations would still be regarded as productive if they took place over space (shipment of oranges form Cairo to Alexandria)

or over time (storing of potatoes after harvest so as to distribute consumption over the year).

Of course, to be economically rational production should represent a conversion from a less desired to a more desired configuration. To burn an antique Chippendale chair for heart is a kind of production, but ill-advised under ordinary conditions. (On the other hand, an individual on the point of freezing to death might find the conversion from chair to warmth exceedingly advantageous.)

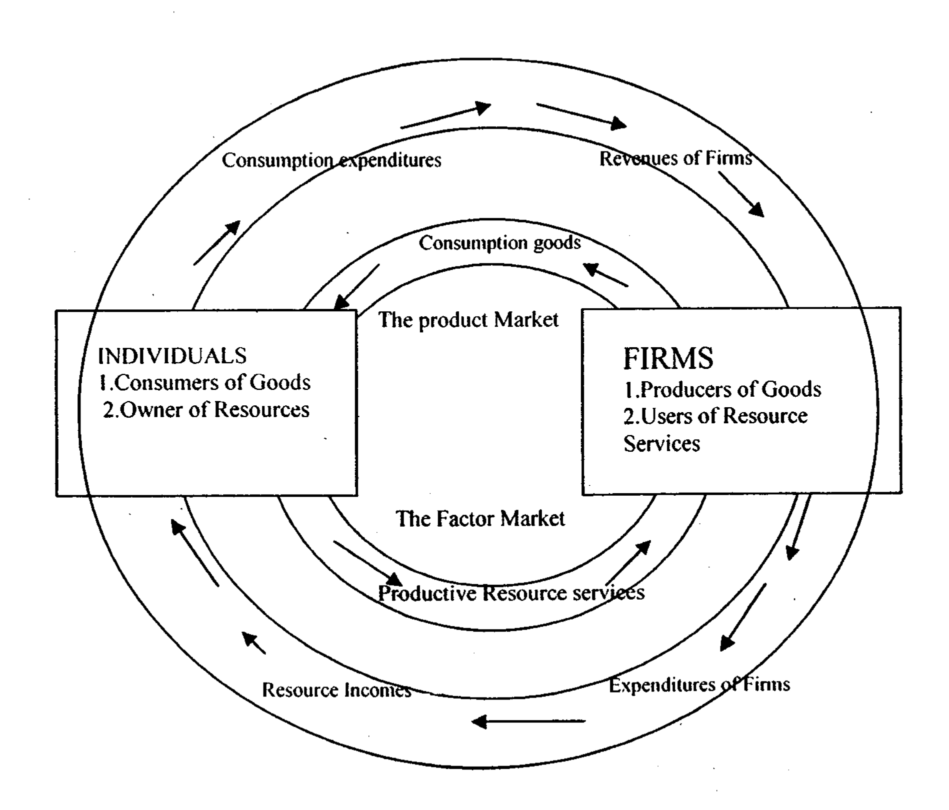
The third main economic activity is for the individual, exchange is also a kind of conversion-he or she trades away some objects for others. But from the social point of view, exchange is distinguished form production in that the totals of commodities are unaffected; goods and services are reshuffled in trade, but wherever one person has less, some else must have more. Thus, exchange is a kind of transfer.

But it is a mutual and voluntary transfer; all parties involved are satisfied. The objects of choice in exchange activities may be either consumption goods and services or production goods and services.

In a simplified world with only two types of economic agents, individuals and business firms, the relations between them can be pictured as in figure 1.1. individuals and firms have dual aspects,

and thus transact with one another in two distinct ways. Individuals are in one aspect consumers of goods, while firms are producers of goods. Thus, the diagram shows a "real" flow of consumption goods (solid upper channel) from firms to individuals. But the goods must be produced. To permit this there must be a "real" flow of productive services (solid lower channel), from the individuals in their aspect as owners of resources to the firms as employers of resources services.

The circular Flow of Economic Activity



2 –9 . Economic analysis and economic policy

Economic analysis is the attempt to understand the economic world. And economic policy is the attempt to improve it. Another way of putting the distinctions is this: analysis makes predictions while policy offers prescriptions. Policy and analysis overlap in many ways and policy cannot get far without analysis. It is not possible to make something work better without first understanding it.

(A) Economic Analysis

Economic is a social science (along with political science, psychology and sociology) and a major task of economists is to discover how the economic world works. In the pursuit of this goal, economists (like all other. Scientists) distinguish between two types of statements:

❖ **What is and What ought to be**

Statements about what is. Are called positive statements. They say what is currently believed about the way the world operates. Positive statements might be right or wrong. They can be tested by checking them against the facts. Statements about what ought to be are called normative statements. These statements depend on values and cannot be tested.

It is the task of economic analysis to discover and catalogue positive statements that are consistent with what we observe in

the world and that enable us to understand how the economic world works.

This rask is a large one and it can be broken into three steps:

* **Observing and measuring**
* **Building models**
* **Testing theories**

(B) Economic policy

Economic policy is the attempt to devise government actions and to design institutions that might improve economic performance. Economic play two distinct roles in the formulation of economic policy.

First, they try to predict the consequence of alternative policies. For example, health economists try to predict the cost and benefits and effective ness of alternative treatments, and alternative ways of financing and organizing health care. Economists who work on environmental issues attempt to predict changes in the cost and quality of urban air resulting from changes in vehicle emission standards. Macroeconomists, on the other hand, try to predict the effects of interest rate changes on the stock market and employment.

Second, economists evaluate alternative policies on the scale of better to worse. To do this they must state the policy

objectives. Provided there is clarity and openness about the policy objectives.

This type of policy evaluation can be as objective and scientific as the development of economic theories. Over the years by responding to the societies of which they are a part and interpreting sentiments expressed in the political arena. Economists have developed criteria for judging policy outcomes on the better to worse scale. Four objectives of policy have emerged: Efficiency / Equity, Growth and Stability.

1- **When economic efficiency** has been achieved production costs are as low as possible and consumers want the combination of goods and services that is being produced. Three distinct conditions produce economic efficiency. They are efficient production efficient consumption and efficient exchange.

   Efficient production is achieved when each firm produces its output at the least possible cost. Cost includes home by the finn and costs borne by others Efficient consumption is achieved when everyone buys the goods and services that make them as well off as possible. By their own evaluations. Efficient exchange is achieved when everyone specializes to cam a living by doing the job that gives them the maximum possible. Economic benefit Economic

efficiency is desirable because when it is achieved it is not possible to make one person better off without at the same time making someone else worse off.

2- **Equity is economic justice** or fairness. An efficient economy is not necessarily and equitable or just one. Economic efficiency could bring very lare incomes to a few people and very low incomes to the vast majority. Such a situation would be regarded as inequitable by the majority but possibly not by everyone. While economists agree that policies which improve equity are desirable. There is little consensus on the definition of equity of economic justice. There is some consensus on what constitutes extreme inequity but equity remains a matter on which reasonable people disagree.

3- **Economic growth** is the increase in incomes and production per person. It results from the ongoing advance of technology, the accumulation of ever larger quantities of productive equipment and ever rising standards of education.

Poor societies are transformed into rich ones by economic growth. But economic growth as be cost. It uses up exhaustible natural resources, and sometimes destroys natural vegetation and damages the environment. But these

are not inevitable draw-backs of economic growth and the richest countries are the ones that devote the greatest efforts to enriching and protecting the environment.

Economic growth can be encouraged or discouraged by the policies that government adopt. For example, tax incentives for research and development might stimulate growth while tax penalties that encourage resource conservation might retard it in reaching policy conclusions, economists must take a view about the desirable growth rate and the effects of the policies being considered on growth.

4- **Economic stability** is the absence of wide fluctuations in the economic growth rate the level of employment and average prices. Economic stability is desirable because it provides the best environment in which individual and firms can make efficient decisions. Almost the whole of macroeconomics has developed to understand the problems of instability and many macroeconomists specialize in designing policies to tame an unstable economy.

2 – 10 . LIST OF DEFINITIONS

1- ANEED

is an essential good or service wt can't live without.

2- A WANT

is a service which one would like to have, but which is not essential for living. People's wants are unlimited.

3- THE ECONOMIC PROBLEM

results from there being unlimited wants but limited resources to produce the goods and services to satisfy those ants. This creates scarcity.

Unlimited Wants + Limited resources = Scarcity

4- SCARCITY

is the lack of sufficient products to fulfill the total wants of the population.

5- OPPORTUNITY COST

is the next best alternative given up by choosing another item.

6- FACTORS OF PRODUCTION

are those resources needed to produce goods or services. There are four factors of production and they are in limited supply. Those factors are:

1. Land
2. Labor

3. Capital
4. Enterprise

7- the main aim of all business

is to combine the factors of production to make products which will satisfy people's wants.

8- DIVISION OF LABOUR

is when the production process is split up into different tasks and each worker performs one of these tasks. It is a so known as SPECIALIZATION.

CHAPTER 3

DEMAND AND SUPPLY

3 – 1. Introduction

In a free market scarce resources are allocated by The Price mechanism. It is there fore of vital importance of economists to be able to explain how prices are determined. 'Market prices are determined by the interaction of Supply and Demand.

Throughout this unit relationships have been simplified. The reader must remember that in the real world economic relationships are generally much more complicated.

3 – 2 . Demand

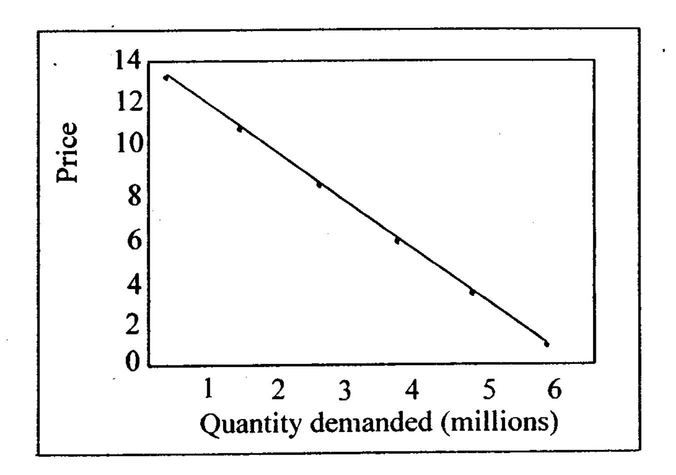
Definition: 'The amount consumers are willing and able to purchase at a given price per period of time.

Demand needs to be 'effective', i.e. backed by necessary money. The individual demands of people are added together to form the market demand. This is illustrated in Fig. 3.1.

The demand schedule for LPs per week (millions)

Price (E P)	Quantity demanded
2	12
3	10
4	8
5	6
6	4
7	2

Fig. 3.1 Extension of demand



The demand Curve shows the same information as the Demand Schedule but in a graphic form. As the price of LPs rises the 'amount consumers are willing and able to purchase' falls. For instance, at 6,4 million Lps are bought but at 3,10 million LPs are bought. Thus there is I inverse relationship between Price and Quantity Demanded for most normal goods.

3-2-1 . Contractions and extension of demand

Extensions and contractions of demand result from Price changes only. It is assumed that other things, such as conditions of demand below, are held constant. As we can see in Fig. 4.1, when price falls from P1 to P2 the quantity demand rises from Q: to Q2. this is an extension of demand. Conversely when price rises from P2 to P1 the quantity demanded falls from Q2 to Qx. This is a contraction of demand.

3-2-2 . Change in the conditions of demand

It is clear that demand depends upon many factors – not merely price. These are known as the underlying conditions of demand. They can be remembered by the word 'CIST'.

1- Complements

Many goods are in joint demand, e.g. cards and petrol. It is clear that changes in the price of cars will affect not only the demand for cars but also the demand for petrol, as the two go together. Generally, if the price of a complementary good increases then the demand for the jointly demanded good is likely to fall. Thus if the price of petrol rises, demand for cars is likely to fall.

2- Income.

If you were to receive an increase in income (e.g. from a Saturday job) you would be in a position to increase your demand for LPs even if the price remained unaltered.

It is clear that changes in the level of income are likely to have a considerable impact on demand. Furthermore changes in the distribution of income will also affect market, though not individual, demand. For example, if income tax becomes more progressive the demand for luxuries may fall and the demand for normal goods may in crease.

3- Substitutes.

Many products have a number of close substitutes or goods which may be consumed instead. For example, many people would be largely indifferent as to whether they eat cabbage or cauliflower for dinner. Hence if the price of cauliflower suddenly rose, consumers are very likely to buy cabbage instead. Thus when the price of a substitute good rises, demand for the original good increases too.

4- Tastes and fashions.

This will obviously be a major factor affecting the demand for certain products. Many people would not be 'seen dead' in last year's style of clothes no matter how cheap they are now. Tastes can be influenced by advertising.

Thus over the past decade demand for lager has risen while the demand for bitter has fallen. The health food mood has led to more demand for brown bread and vegetable oil margarine and less for white bread and butter.

3-2-3 . Graphic representation of changes in the conditions of demand

A demand curve shows only the effects on quantity demanded of chages in price. To demonstrate the effects of changes in the conditions of demand it is necessary to shift the entire demand curve. A new demand schedule has occurred.

Price (E P)	Quantity demanded (D2)
2	14
3	12
4	10
5	8
6	6
7	4

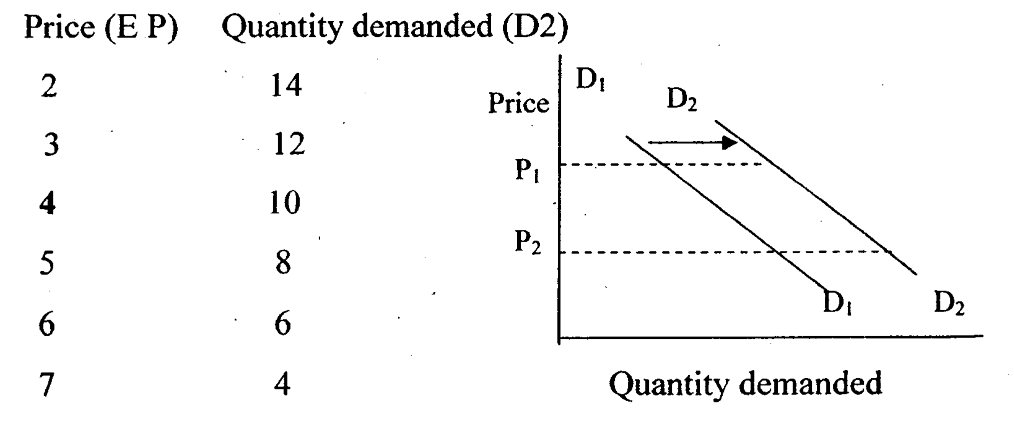


Fig. 3.2 Increase in demand

An increase in demand means that more of a good is demanded at each price than before, and thus results in a completely new Demand Curve.

After an increase in income existing consumers will be able to afford more LPs and new customers will enter the market. Hence at each price the quantity demanded has risen (e.g. at 6,6 million LPs are bought now instead of 4 million). A new curve (d2) is thus parallel and to the right of the original curve. Always remember to include an arrow showing the direction of change.

A decrease in demand may have been caused by:

1- An increase in the price of Complements.

2- A reduction in the level of Income perhaps caused by a lower level of taxation or increased wages or both.

3- A reduction in the price of Substitute goods.

4- An adverse change in Taste or fashion.

These can be remembered by 'CIST'

3.4. Supply

Definition: The amount producers are willing to offer for sale at any given price. 'As with demand, price is a major influence on quantity supplied. As price rises so does profit, therefore, new suppliers are attracted into the market and existing firms are tempted to increase production.

3-4-1. Supply Schedule

LPs per week (millions)

Price	Quantity supplied
2	2
3	4
4	6
5	8
6	10
7	12

This market supply schedule is a combination of the supplies offered onto the market by all the individual producers.

In Fig. 3.3 as price rises from P1 to P2 so Quantity Supplied rises from Qx to Q2. Vice versa when price falls .

3-4-2. Contractions / extensions of supply

Figure 3.3 shows the extension of supply. This occurs when producers increase supply as the 1 price rises. It shows a movement along a curve and it assumes that conditions of supply) remain unchanged.

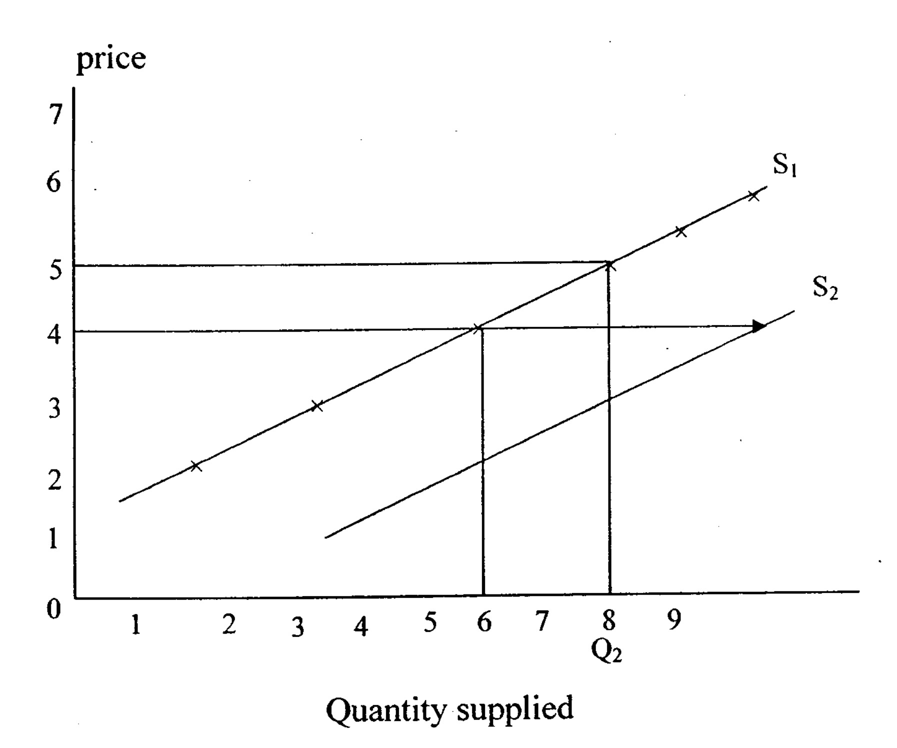


Fig. 3.3 Increase in supply and extension of supply

3-4-3. Conditions of supply

Basically anything that influences profit will affect the conditions of supply. There are number of conditions of supply which may change and produce a new supply curve. These can be remembered by the word 'COPING'.

1- Costs

This item refers to the cost to the firm of paying the factors of production if a firm has to pay more for its raw materials, etc., it will require a higher selling price in order to maintain its normal

profit at existing output levels. An increase in costs will lead to a decrease in profit and therefore a reduction in supply.

2- Other prices

- the impact of other prices depends on the relationship between the good being supplied and other goods.

- Unrelated goods. If the price of ice cream rises it will not induce BL to switch its long-bridge lines to the production of Raspberry Ripple!

- Goods in competitive supply. However, many firms are capable of switching production at relatively short notice and will do so if higher profits can be obtained. For instance, a market gardener of peas is likely to react to high carrot prices by planting more carrots and fewer peas next season.

- Goods in joint supply. The production of one good leads to production of another, e.g. if farmers raise more cows, this will increase the output of leather even though its price has remained unchanged.

3- Innovations.

We live in an age where rapid technological change is the norm. Thus firms are often able to use technological change to produce goods much more cheaply, e.g. the use of robots and computers.

4- Government policy.

Here we are particularly concerned with the effects of Indirect taxation and Subsidies upon the supply curve. For instance, an increase in VAT means that suppliers will wish to sell the same quantity at higher prices and so the supply curve will shirt to the left. When a tax is imposed the producer receives the selling price less the tax-this reduces profit and therefore decreases supply. Vice versa for a subsidy.

3-4-4. Graphic representation of changes in the conditions of supply

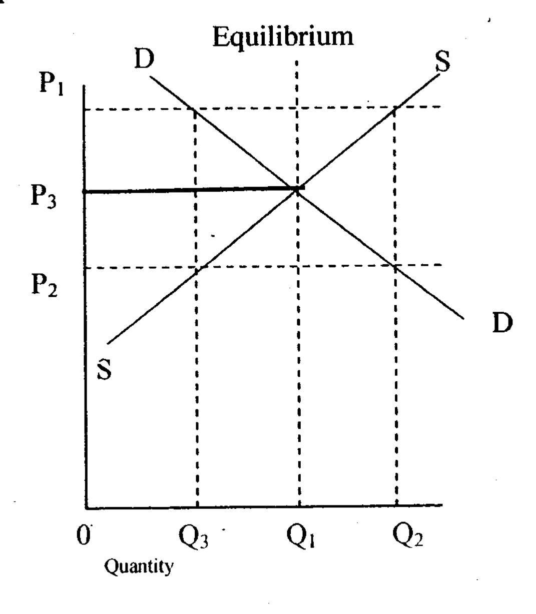
As with demand, the supply curve shows only the effects on changes in price upon quantity supplied. To demonstrate the effects of changes in the conditions of supply it is necessary to shift the entire supply curve. (See Fig. 4.3.)

An increase in supply shifts the supply to the right. This may have been caused by COPING':

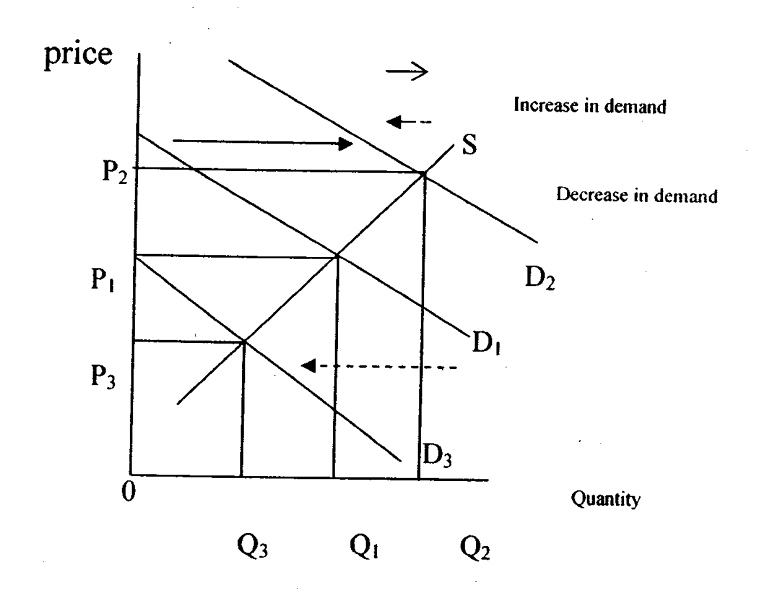
1. A reduction in factor cost,
2. A fall in the price of other related goods 3 A technological breakthrough 4 A government subsidy.

3-5. Price

Definition: price is determined by the interaction of supply and demand .



Equilibrium price and quantity



The of changes in the conditions of demand

3-5-1. Equilibrium

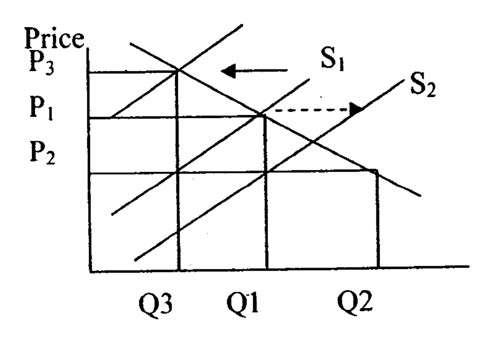
is defined asThe position from which there is no tendency to change.

In oben Fig. at price P1, demand is OQa while supply is OQb thus indicating an Excess supply. In this situation suppliers, as in the January or summer sales, will lower their prices to eliminate this excess supply. Thus at all prices above Pe there will be excess supply and a tendency for price to fall, until demand and supply are equal at the equilibrium price.

At PZ there is clearly an Excess demand thus at all prices below Pe buyers will bid up prices in order to obtain goods which are is short supply, e.g. sugar. At Pe there is neither a tendency for price to rise nor to fall, thus Pe represents equilibrium price.the effect of a change in conditions of demand: in Fig. 4.5 we can see that following an increase in demand (D1--> D2) both equilibrium price (P1,P2) and quantity (Q1---+QZ) will rise. Conversely when demand falls (1), - D3) so too will equilibrium price (P1-+P3) and quantity (Q1 – Q3)'

3-5-2. Effects of a change in conditions of supply

In Fig. 3.6 as supply increases (S1--+
S2) equilibrium price falls (P1--+ P2) but
Equilibrium quantity rises (Q1--> Q2). Si-
Milarly when supply falls (S 1->S3) equilibrium price rises (P1+P3) but equilibrium quantity falls (Q1- Q3).



The of changes in the conditions of supply

Chapter 4

Elasticity

The shape of a demand curve is known as its elasticity. It tells us by how much demand will change in response to price changes'.

4-1. Definition

Elasticity is defined as: The responsiveness of supply/demand to a given change in price.

4-2. Measurement of price elasticity of demand

Elasticity is measured by the Coefficient of elasticity .

% QD= percentage change in quantity demanded of the good

% P percentage change in price of the good

Calculation can be: (a) over a range of prices, (b) at one point a curve, or (c)over the whole curve. It is normally calculated between two prices.

Examples. If a price increase from $5 to $6 brings about a fall from 6 million to 4 million

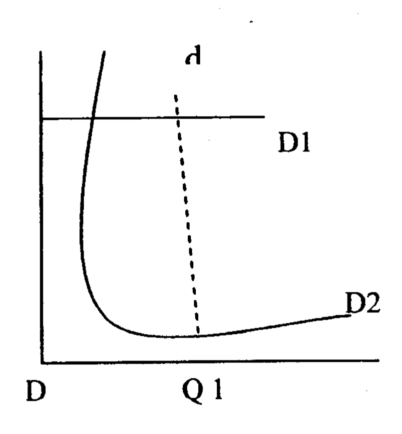
Note that the same data give a different result if a price fall is considered.

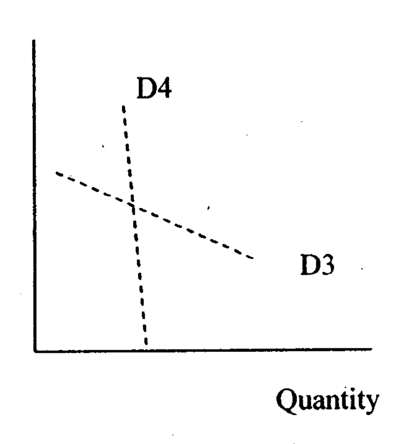
In calculating Σ D the minus symbol is usually ignored.

In these two cases the D curve is relatively elastic, indicating that demand is very responsive to price changes. The Σ D formula gives a value between 1 and co (infinity). Conversely, the quantity demanded may be very unresponsive to price changes. For instance, when price of LPs fell from \$3 to \$2 quantity demand increased from 10 million to12 million.

Then % Qd ÷ % p = +20 ÷ -33.3 = 0.6

In this latter case ΣD is less than 1 which indicates relatively inelastic demand. Elasticities between 0 and 1 show relatively inelastic demand .





D = Pefectly inelastic derrand curve
DI = Perfectly elastic demand curve
D2 = Unitarv etasticltv of demand

1- **Perfectly inelastic demand** occurs when demand remains constant at Q irrespective of price. In this case Σ D= 0 and demand is said to be perfectly inelastic.

2- **Perfectly elastic demand** is represented in Fig. 3.7 by curve DI as at any price above PI demand falls to zero and demand is said to be perfectly elastic.

3- Unitary elasticity is a special case where % -- QD = % -- P at all price/output levels along D2 hence Σ D = 1 and demand is said to have unit elasticity. In this situation Total Revenue [P x Q] will be unchanged following a price change. A demand curve with a constant unit elasticity is called a **rectangular hyperbola.** These curves are all theoretical special cases and we should expect to find most cases where demand is either relatively elastic (D3) or relatively inelastic (D4).

4-3. Straight-line demand curves

It is important to note that elasticity will vary along the length of any straight line demand curve. As the quantity demanded increases, the curve becomes more inelastic. See Fig. 3.9.

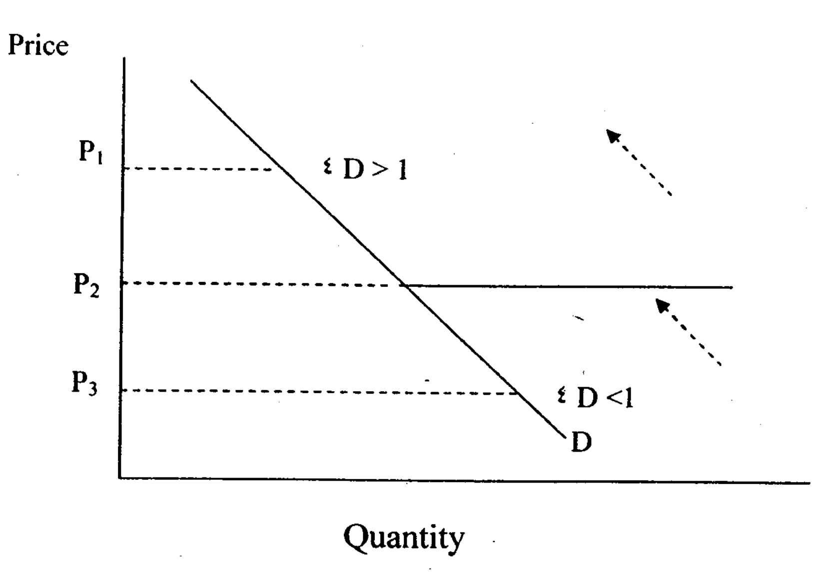


Fig . 3.9 A demand curve of varying elasticity

4-4. Factors influencing (price) elasticity of demand

These can be remembered by the word **'THIS'**.

1- Time

In the short term consumers may not fully appreciate possible alternatives and thus continue to purchase certain goods following a price rise. However, in the longer period they will become more aware of other possibilities. Therefore, ceteris paribus, demand is more elastic in the long run .

2- Habit

Quite often we purchase goods automatically without, perhaps, being fully aware of the price which we are paying, e.g. newspapers, milk. Thus goods which are habitually bought are more likely to be in inelastic demand. Furthermore some products have an addictive effect, e.g. cigarettes. The nicotine addict will continue to burn away his/her money almost regardless of price.

3- Income

Some goods constitute only a small proportion of consumers' income, e.g. matches. In this case even a 100 per cent rice in the price of matches can be quite easily absorbed since most consumers spend only a tiny fraction of their income upon matches. Demand is thus likely to be inelastic. Compare this with how you think consumers would creact to a doubling of care prices.

4- Substitutes

Possibly the single most important factor is the closneness and availability of substitutes For example, petrol has no genuinely

effective freely available substitutes. Thus motorists have little option but to keep on buying it.

However, faced with a rise in the price of cabbage the consume has a wide range of more or less acceptable substitutes to choose from. Thus the demand for petrol is inelastic while the demand for cabbage tends to be elastic. In general the more substitutes and the closer the substitutes the more elastic the demand.

4-5. Measurement of elasticity of supply

The co-efficient of elasticity of supply is defined as

$$\Sigma S = \frac{\%\ QS \text{ proportionate change in quantity supplied of the good}}{\%\ P \text{ proportionate change in price of the good}}$$

When (a) $\Sigma S > 1$ supply is said to be Elastic.

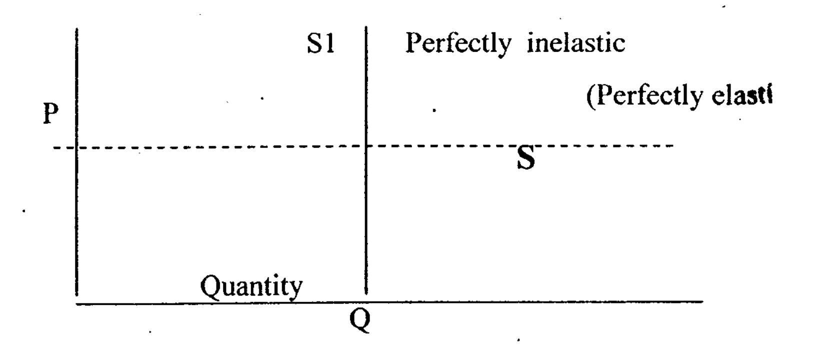
(b) $\Sigma S < 1$ supply is said to be inelastic, and

(c) $\Sigma S = 1$ supply is said to have unit elasticity.

1- **A perfectly Inelastic supply curve** has $\Sigma S = 0$ and is illustrated in Fig. 4.10. supply dose not respond to price changes at all. Unlike perfectly inelastic demand, $\Sigma S = 0$ may be observed in many real-world cases during the shot run. Consider a farmer, once he/she has planted the seed the eventual harvest will depend upon climatic conditions and changes in price will have no effect at all upon supply. In the long run, however, we would expect farmers to adjust the pattern of their crops in the light of price fluctuations.

2- Perfectly Elastic supply is shown by S2 in Fig. 3.10 its Σ S = a, i.e. If price falls below P2 then producers will be willing to offer nothing for sale at all. Unlike perfectly inelastic supply, Σ S = a is a purely theoretical concept.

We can see that any straight-line supply curve through the origin will have a constant Σ S of 1 .



Different supply curves

4-6. Factors affecting elasticity of supply

1- Time.

In most manufacturing industry production plans can be altered relatively quickly, bearing in mind that contracts for purchases of raw materials, etc., are often binding for around six months. However, in agriculture the eventual size of the harvest, once the seeds are planted, depends upon climatic conditions.

Current market prices will have no effect upon crop yields at all. It takes seven years for a newly planted rubber tree to yield its sap, hence we can see that in many cases supply is likely to be more inelastic in the short run. Generally, the elasticity of supply increases over time.

2- Factors of production.

Manufactures can only respond to increased prices if the Extra factors of production are freely available. If, however, the factors of production are unavailable or available only at an increased cost, Then firms may be less inclined to respond to rising prices by increasing output. Thus supply will tend to be more inelastic.

4-7. USES OF ELASTICITY

A knowledge of real-world elasticities will be vitally important to both **government** and **industry.**

Governments are able to raise revenue by taxing goods with an inelastic demand. Businesses will use their market research to enable them to evaluate the likely effects of any changes in the price of their products, thus helping them to maximize their profits.

Income elasticity of demand

This concept shows the responsiveness of demand to changes in income. It is calculated by percentage change in demand.

Percentage change in income For example, if income elasticity of demand) = 8/10 =4/5.

As the Y. Σ d is between 0 and 1 the good would be considered as normal.

Chapter 5

Production and Cost Theory

5 – 1 . The meaning of Production

The term Production includes all those activities which create the goods and services consumers are prepared to pay for in order to satisfy human wants. The production process is not completed unit the good or service is in the hands of the final consumer.

For instance, the production of any good involves not only the work of miners, farmers and factory workers but also the services of bankers, solicitors accountants, wholesalers, retailers and transporters. They are all part of the production process.

Exchange is important to production because for any activity to productive, it must be wanted and consumers must be willing to buy the good or service. If consumer are not willing to buy the good or service, i.e., to consume it, then that good or service is not part of production. All productive processes are directed towards consumption which is the using of goods and service to satisfy human wants.

The production process is often divided into three categories, primary production, secondary production and tertiary production.

5-2. What is being produced?

In economics we are only concerned with the production of economic goods. These are goods which are scare and consumption of them involves opportunity cost (i.e., soothing has to be given up in order to satisfy the want for the goods). Free goods are not scare and can be consumed without the problem of choice and opportunity cost. We have already given air as an example of a free good.

1- Producer goods and consumer goods

Economic goods are classified into two types. Producer (capital or investment) goods are those goods are not wanted for their own sakes, but because they will produce other goods (ie, other capital or consumer goods). Factories, machinery, and tractors are example of these goods. Consumer goods are goods which directly satisfy consumer wants and are wanted for their own sakes.

2- Durable and non-durable consumer goods

Durable consumer goods are those which have a long life and give satisfaction over a long period of time. These would include motor cars, furniture, televisions and most domestic

electrical goods. Non-durable consumer goods are those which are consumed and give satisfaction for only a short period (perhaps for only a single usage). This would include food, drink and cigarettes.

3- Services

These are invisible but nonetheless give satisfaction to consumers. Examples include leisure activities, education, accountancy, banking and health services.

4- Commodities

This term includes all economic goods and services.

Merit goods, and de-merit goods

Merit goods are those which give benefits to society in their production, for example, education and health. De-merit goods cause adverse social costs and cause some harm in their production, such as those industries causing pollution and environmental damage.

5-3. The meaning of wealth

A community's stock of its capital and consumer goods is often referred to as its wealth. An important aspect in this is that gross investment should be greater than depreciation (or capital consumption).

Gross investment is the addition to a community's stock of capital goods whereas depreciation is the wear and tear of capital goods in the same time period.

If gross investment is greater than depreciation, then a community has net investment and will be increasing its wealth. It can produce more and caporal goods which will increase the standard of living of the community.

If, on the other hand, gross investment is less than deprecation then a country will have fewer capital goods and lower national wealth and eventually a lower standard of living.

5-4 . Factors of production

The quality an d quantity of production depends on:

A- Land

B- Labor

C- Capital

D- Enterprise

A main influence on any country's total volume of production is the quantity and quality of its productive resources. Another name, perhaps more widely used, for productive resources is factors of production. There are four main factors of production, land, capital, labor and enterprise.

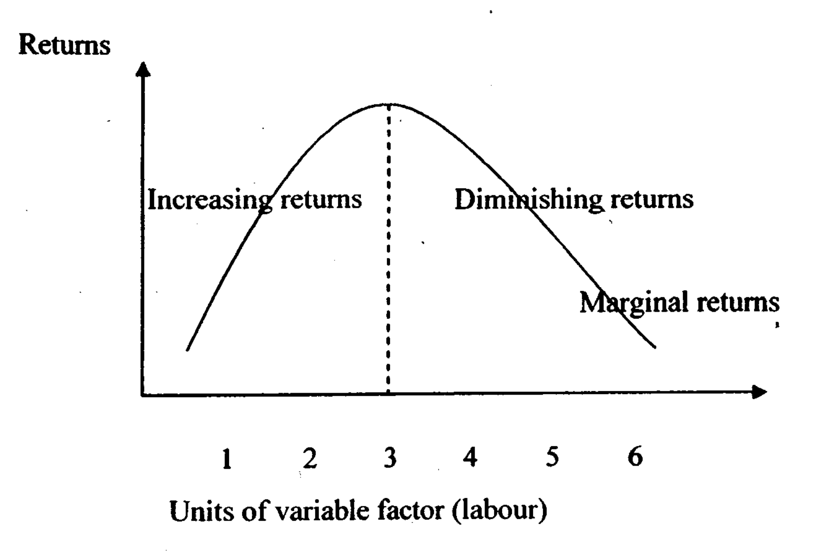
A- Land

Land is used in its widest sense in economics to include all kinds of natural (as distinct from manufactured) resources, such as farm lands, mineral wealth, coal, metal ores, fishing grounds and climate Perhaps the main service of land is the provision of space where production can take place.

The classical economists of the early nineteenth century considered land to be fundamentally different from the other factors because land is a gift of God, supply of land is fixed and industries dependent on land are subject to the law of diminishing returns.

This law states that as successive units of variable factors of production (those which an be increased or decreased in supply, probably labor and capital) are added to a unit of fixed factor of production (which cannot be increased or decreased in supply, probably land), then after a certain point there will be diminishing return – the increase in output will be less than that caused by previous unit of variable factor.

For instance, the third person may add more to output than did the second person, but if the fourth person adds less than the third person and the fifth person less than the fourth person, then diminishing have set in.



These three contention have been criticized. The fact that land is a gift of God is of little economic significance because human beings utilize land to make it useful.

The view that land is strictly limited in supply is not quite true. Irrigation, land reclamation and better farming techniques increase corp yield and land supply. The contention that industries dependent on land are subject to the law of diminishing returns is true.

However, non-land dependent industries also suffer diminishing returns. The law of diminishing returns does not only apply to land-based industries. Land is said to earn an income or reward called rent.

B- Capital

This includes a varied assortment of resources – factory buildings, tools and machinery, raw materials, partly finished goods and means of transport. These things are not required for their own sakes but to assist in the production of other commodities.

Capital is not the same as money but is measured in terms of money. When we discussing capital. Capital is an important part of a community's wealth Social capital is that part of a community's stock of capital which is not directly concerned with the production of goods and services but still assists the production process. This would include schools, hospitals and houses.

How is capital accumulated?

For capital to be created, a community needs to spend less on consumption and divert resources into the production of capital goods. The act of forgoing consumption is called saving, but these savings have to be borrowed by entrepreneurs and used to create new capital goods.

The creation of new capital goods is called investment. As we have already seen, if gross investment is greater than depreciation (or capital consumption) then a community's stock of capital should increase and it should become wealthier and

have a higher standard of living. Capital earns an income or reward called interest.

C- Labor

By labor is meant the mental and physical human effort employed in production. There are special problems involved in labor because it has a human element. Unemployment of labor is, for example, of special concern to economists. Labor earns a reward or income called wages. Production is determined both by the quantity of labor in a particular community.

THE SUPPLY OF LABOR

This is determined by:

- The size of total population The more people in a community then probably the greater the supply of labor.
- The proportion of labor available for employment. The age composition of a population will greatly determine the size of the working population, which is that proportion of the population which is willing and able to work. In Egypt, at the moment, the working population consists of all those over the age of 16 years, who are willing and able to work.
- The number of hours worked by each individual. This is itself determined by the length of the working day, the length of the working week and the number of holidays. In recent years, the number of hours worked by each individual has

declined with a shorter working week and more holidays. However, production has increased. This is due to greater output per worker (or productivity) due to better machinery and technology.

- The wage level Generally at higher wages the supply of labor increase and at lower wages the supply of labor declines. This is only a general rule because at certain high levels of wages, workers may decide to work less and enjoy more leisure, knowing that the wages they will still earn relatively high.

The efficiency of Labor

Production does not only depend on the supply of labor but also on how efficient that labor is. The efficiency of labor depends on.

- **The quantity and quality of social services** .The healthier and happier the labor force, then the greater the probability that production will be high in the United Kingdom for example the Welfare State provides pensions, health care, unemployment and social security benefits which should ensure that the labor force is healthy and happy.

- **Working conditions**. Workers will work harder if the place of work is pleasant. A comfortable working environment is

important in making labor efficient. Nobody wants to work in cold, damp or miserable conditions.

- **Education and training.** Workers need to be well educated and well trained if they are to be efficient. Modern industry requires many skilled workers who need to literate and well educated. In Egypt schools attempt to provide a good basic education.

- **The efficiency of other factors of production.** Labor can only work efficiently if it is combined with efficient machinery and factories and if the quality of land and enterprise is of a high standard.

- **Incentives.** Labor will work efficiently if it has sufficient motivation. A high level of wages and job satisfaction are important considerations here. Also, the method of payment can be used to motivate workers by the use of bonuses and overtime payment.

PRODUCTIVITY

This is a measure of output flowing from the use of given amounts of resources. Labor productivity is usual expressed as the number of units of output produced per person per unit of time (i.e., output per worker).

A high level of productivity indicates efficiency and is regarded as a significant factor in achieving economic growth

and a higher standard of living. Indeed the United Kingdom's disappointing economic growth record up to the early 1980s is often blamed on poor levels of labor productivity.

There are several factors which influence a higher level of labor productivity.

- The use of more and better capital equipment increase labor productivity as old and out-of date equipment is replaced.
- Improvements in organization such as more division of labor and economic of large-scale production.
- A better quality labor force-better skills and better educated.
- Concentrating production on those industries which are already expanding and growing. Reducing the amount of labor involved in declining and contracting industries.
- Government policies aimed at achieving all of the other factors, for example, encouragement for investment and re-training of labor directed towards expanding industries.Of great concern to economists is the fact that labor tends to be occupationally and geographically immobile.

E- Enterprise

The early nineteenth century economists saw only three factors of production, but Alfred Marshall, who wrote Principles of Economics in 1890, saw one more factor – the entrepreneur

(or organizer). It is the entrepreneur who decides what is to be produced and who makes decisions to bring the other factors of production together to produce goods and services.

Many economists say that the entrepreneur is not a separate factor of production, but is linked to labor. These economists argue that organizing is required of all labor from the lowest employee to the managing director.

Other economists maintain that the entrepreneur is a separate factor because the entrepreneur is not only concerned with organizing a single piece of work but this organizing covers all the factors employed. He or she also has to decide what to produce, how to produce and where to produce.

Without the entrepreneur, land, labor and capital are just masses of resources of no economic importance. It is the entrepreneur who organizes them for production.

The main functions of the entrepreneur include:

1- Uncertainty (or risk bearing when an entrepreneur organizes the factors of production he or she is really like a manager. What distinguishes the entrepreneur from the manager is that the entrepreneur came the risks of production. The entrepreneur engages labor and buys raw materials and machines now, in order to produce a good which will be sold

in the future Perhaps in the mean time taste may change or rival may produce a better of cheaper.

Profit (or loss) is the reward for uncertainty bearing and product whoever accepts this ultimate risk is the entrepreneur. The most fundamental fact in connection with organization, it has been said, is the meeting of uncertainty.

2- Management control. This would involve delegating responsibility to the right person.

3- How much should be produced and by what method? Should the firm use mostly labor (labor-intensive) or mostly capital (capital-intensive)?

The entrepreneur can be an individual, the government, or a large limited compa ιy.

5-5.Types of Production

1. Extraction of raw materials: from the earth i.e. coal-mining. This sector is providing less employment because machinery is replacing manpower.
2. Conversion of raw materials into finished products:
3. Providing of services:
    a. Commercial services: services seek to make a profit, i.e. mechanic, food services.
    b. Social services: Services provided free or subsidized at a cheap rate by the government. They are not

given to make a profit but in order to meet a need. i.e. public health and education.

5-6 . THE COSTS OF PRODUCTION

The costs of production are the monetary expenditures on the use of factors of production, on such items as labor, raw materials, power and transport. To the economist, costs are the same as opportunity cost.

For instance if an entrepreneur hires a factor of production such as labor, then the cost of production is what has to be paid for the use of that labor, ie wages. Moreover if the entrepreneur works privately or uses personal money in the firm then this also has a cost.

For instance, by being self-employed the entrepreneur has forgone a wage by not working for another firm. By using his or her own money in the firm, the entrepreneur is forgoing the interest which that money could have eared, if it was saved in a bank or building society. Thus the economist is concerned with the real cost of producing a good which is the same as the opportunity cost (the cost of the next best alternative which has been forgone).

5-6-1 . DIFFERENT CATEGORIES OF COSTS

1- Fixed costs and variable costs

A- **Fixed costs** (overheads or indirect costs) are those costs of the fixed factors of production – those resources which cannot be varied in supply in the short run, such as land. The short run is not a specified period of time and varies in length from industry to industry.

For instance, the short run for fresh vegetables may be the short summer reason. Whereas the short run for the industry may be a period of years. Fixed costs include rent, rates, interest on loans, salaries and depreciation on capital.

B-Variable costs (direct or prime costs) are those costs of variable factors of production – those resources which can be varied in supply even in the short run such as labor and raw materials. Wages are a good example of a variable cost. Variable costs will increase and decrease as output decreases.

In the long run, again an unspecified period of time varying from industry to industry, all factors of production are said to become variable. This is because even the fixed factors of production are said to become variable. This is because even the fixed factors of production such as land can be increased or decreased in supply in the long run.

This distinction between fixed costs and variable costs is important because in the short run so long as revenues (or receipts) cover variable costs, the firm will go on producing. This is because fixed costs will exist anyway even if the firm closes down.

Therefore if the firm is at least covering its variable costs then it is doing at least as well as if it produced nothing at all if the firm's revenues did not cover variable cost then it would be making more of a loss by producing than if it ceased to produce altogether.

In the long run the firm must cover, with its revenues, both fixed and variable costs (called total costs) because the firm is not faced with fixed costs in the long run and can eliminate all costs of production if so desired by closing down the business. Therefore, in the long run the firm will only produce if it has covered all of its costs.

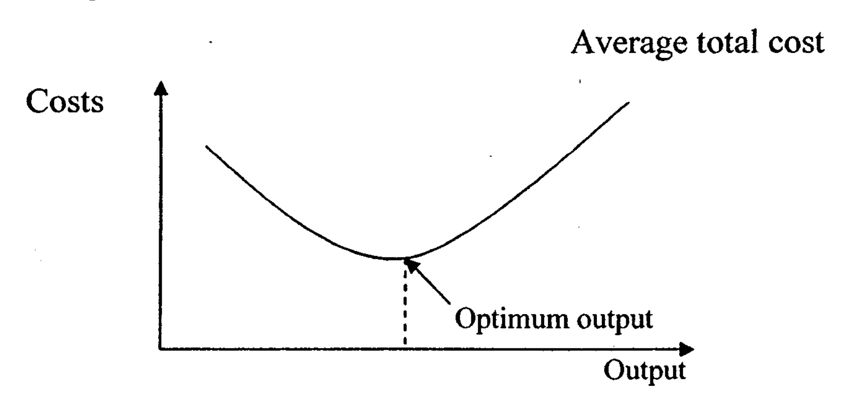
C- Total costs

As we have seen, this is the addition of fixed and variable costs and must be covered by the firm's revenues in the long run. Total costs will always rise as output rises because variable costs always rise as output rises. If the firm is not covering its total costs with revenues in the long run then it will be better to cease trading.

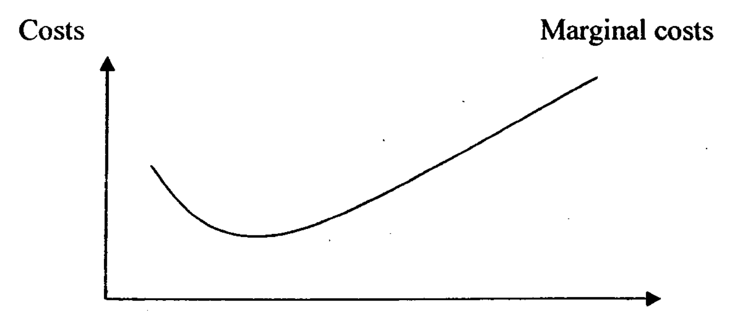
D - Average costs

Average costs are total costs divided by the number of units produced. As output increase average costs first fall and then rise. This is because of the law of diminishing returns and diseconomies of scale. Up to point there are increasing returns and economies of scale to be enjoyed. Where average costs are at their lowest is called optimum output because this is the most efficient or lowest cost level of output.

Marginal costs



These are the costs of producing one more unit and are found by dividing the change in total costs by the change in output. The shape of the curve is such that marginal costs diminish up to a level of output and then increase as the diminishing returns again set in.



Marginal costs are important because where marginal costs are equal to marginal revenue (i.e. the revenue or receipts gained from the last unit produced) then this will be the most profitable level of output.

This is called the equilibrium or profit maximizing level of output. If marginal cost was less than marginal revenue then the first would produce extra units to increase profits. If marginal cost was greater than marginal revenue then the firm would reduce output because it is making a loss on these units. Profits are at maximum where marginal costs equal marginal revenue.

E- Money Costs and Capital Costs

Money costs are the costs in terms of money of producing a good or service. They include fixed costs and variable costs. However, there also social costs which are external costs to society of the production process which may not be included in money costs.

For instance, the money costs of producing coal may be fairly easily calculated to include the wages of the miners, the costs of equipment and machinery, interest on loans and so on. However, there are costs to society as a whole, in terms of the death of workers, pollution of the environment and unsightly coal tips. Thus social costs are the costs to society as a whole, of producing a particular good Merit goods are those goods so called because they confer many benefits on society. De-merit goods confer adverse social effects on society. Alcohol and tobacco are examples of de-merit goods.

Sometimes when a decision needs to be made about whether production should or should not take place, a cost benefit analysis is undertaken. This calculates all the money costs and benefits and compares them with the social costs and social benefits of production. The problem with a cost benefit analysis is that it is very difficult to give a money value to a social cost or benefit. For instance, how does one calculate in money terms the fact that a bird sanctuary may be destroyed by a chemical works?

It is often a criticism of the price mechanism system that, when allocation searce resources the social costs and benefits of any decision are ignored. A private entrepreneur is only concerned with the money costs and benefits – motivated only by profit.

Chapter 6

Market theory

6-1. What is a Firm?

A firm is an institution that buys or hires factors of production and organizes these resources to produce and sell goods and services. The important word in the definition of a firm is "organizes". Someone, or a hierarchy of managers runs the firm.

6-2. How Firms Increase Their Profits?

Technology – Marketing – Human Resources – Quality – Promoting the Product – Advertising – Research – Customer no. 1 – accept complaints and feedback from the customer (McDonalds)

Firms diversity their production to gain more stability in the market, to achieve more profits, for growth.

6-3. What Firms have in common

Firms exist because of scarcity. We use firms to get as much as we can out of our scarce resources. Each firm has to solve its own economic problem. That is, each firm has to get the most it can out of the scarce resources under its control. To do so, a firm has to decide on the following:

1. What to produce and in what quantities .
2. Which techniques of production to use (manual or by technology)
3. The Quantities of each factor of production to employ.
4. The Arrangements for compensating factors of production.

A- Revenue: What the firm receives from the sales of goods and services.

B- Cost: is the total payment made by a firm for the services of factors of production.

C- Profit: the difference between a firm's revenue and cost (if revenue exceeds cost).

D- Loss: Same definition (if cost exceeds revenue)

6-4. perfect competition

perfect competition occurs in a market in which a large number of firms produce an identical good there are many buyers; there are no restrictions on entry and exit: and all firms and buyers are fully informed about the prices changed by each firm. Each firm sells its good for the same price – the market price. It chooses how much to produce, whether to leave an industry permanently.

The firm's choices re motivated by its desire to maximize profit . by maximizing profit the firm can make an economic profit a normal profit- a normal profit – or an economic loss

depending on marker price. If price is low enough, the firm maximizers profit by temporarily shutting down and off its workers.

When price equals minimum average variable cost, the firm incurs a loss equal to its total fixed costs whether it producers the profit – maximizing output or shuts down.

The firm's supply curve is the upward-sloping part of its marginal cost curve above minimum average variable cost runs along the vertical axis at all prices below minimum average variable cost.

6-5. output, price and profit in the short run

The short –run industry supply curve shows how the total quantity supplied in the short run by all the firms in an industry varies as the market price varies. The market price is such that the quantity supplied and the quantity demanded are equal. Each firm takes the market price as given and chooses the output that maximizes profit. In short-run equilibrium each firm can make an economic profit an economic loss. Or it can break even

6-6. Output price and Profit in the Long run

If the firms in an industry make economic profits. New firms enter the industry and existing firm might increase their plant size. If the firms in an industry insure economic losses, some firms will leave the industry and the remaining firms might

decrease their plant size. Entry and excite and changes in plant size shift the sort-run industry supply curve. Entry decreases the economic profit of existing firms and exit increases the economic profit if existing firms (or decrease their losses).

Long-run competitive equilibrium occurs when each firm maximizes profit (marginal revenue equals marginal cost), economic profit is zero (normal profit is earned). So that is no entry or exit and each firm produces at the point of minimum long-run average cost so it has no incentive to change its plant size.

6-7. Changing Tastes and Advancing Technology

In a perfectly competitive market, a permanent decrease (increase) in demand lead to a smaller (larger) industry output and a smaller (larger) number of firms in the industry. If there are no external economies or diseconomies, the market price remains constant in the long run as demand changes. If there are external economies price falls in the long run as demand increases. If there are external diseconomies, price increases in the long run as demand increases.

New technology increases the industry supply, and in the long run the market price falls and the quantity sold increases. Firms that are slow to change make losses and eventually go out of

business. Firm that are quick to change make economic profits initially, but eventually they will make zero economic profit.

6-8. Competition and Efficiency

A locative efficiency occurs when no one can be made better off without making someone else worse off Three conditions for a locative efficiency producer efficiency consumer efficiency and exchange efficiency – occur in perfect competition when there is no market failure. It is this situation that Adam Smith was describing when he talked of the economy being led by an 'invisible hand'

There are five market failure obstacles to the achievement of a locative efficiency in perfect competition – poor information and uncertainty, poor definition of property rights, external costs and benefits, monopoly power and public goods.

Chapter 7

DISTRIBUTION THEORY

7-1. Meaning of Distribution

Distribution in the economist's language may have three meanings:

1. **Physical** distribution refers to the distribution of goods from producer to consumer. This is the subject matter of the student of marketing and does not particularly concern us here.
2. **Personal** distribution refers to the division of income among persons. It refers to the size rather than to the type of the individual's income.
3. **Functional** distribution refers to the division of income according to different types of income – wages, rent, interest, profit. It is this aspect of distribution which has traditionally been of the greatest interest to the economist.

The question of how income is distributed among people makes sense only because we know that people do not share the national income equally. Some get more than others. If income were to be shared equally, there would still be the question of what is meant

by equality. Should every individual receive his proportional share, regardless of his age and his needs, regardless of whether he lives alone or with members of his family? This would make the large family much better off than the individual who lives by himself.

The subject of functional distribution has two parts. The first deals with the distribution of income among the four distributive shares (wages, interest, rent, profit).

The second part of the subject of functional distribution deals with the prices paid for factor services (Land, Labor, capital, Management), and received by the sellers of factor services; it deals with wage rates. Interest rates, speçific rents, and profits.

7-2. **Distribution Theory and Price Theory**

In so far as distribution theory deals with factor prices, it is a part of price theory, The same general analytical apparatus applies whether we deal with the price of steel or the price of labor to make steel. Demand for labor and supply of labor together determine the price of labor.

1- INTEREST

A- Definition

Interest is generally said to be the price paid for the use of funds. ("Funds" means media of exchange-de-posits, notes, or coins.) Interest must be paid by borrowers to lenders. Interest may also be defined as the income derived from lending funds.

Until a few years ago economists almost invariably defined interest as the price paid for the use of capital, or the income received by the owners of capital. This definition, still acceptable to many economists, contains a contradiction. Capital, in the economists' sense, is defined as: goods produced and not yet consumed; or; man-made goods used in producing other goods. The price paid for the use of such producers' goods is called rent, not interest. Thus when the X Manufacturing Company uses a building belonging to another firm, it pays rent for the building. It pays interest only to firms or persons from whom it has borrowed funds.

B- Interest and Discount

Interest is a payment made at the time the loan matures or at various times (e.g., annually or quarterly) during the life of the loan.

Frequently the payment is made in advance i.e., at the time the loan is made. For example: a bank makes a loan of $5000 for one year at 4 per cent per annum. The borrower gives the bank his promissory note for $5000 payable one year later. The bank gives the borrower a deposit or other currency amounting to $5000 less 4 per cent, or $200. The $200 is called the discount.

C- Market and Effective Rates of Interest

The market rate or going rate of interest is the rate actually paid in the market. If the market rate is 4 per cent at the time Y Corporation issues the bonds, the corporation will be able to float its 5 per cent bonds for more than their par or nominal value of $100 each.

The effective rate of interest or the yield of the bond is the rate of return which the holder gets on the sum be paid for the bond. The purchaser who bought the 5 per cent bond for $80 (at a time when the market rate was over 6 per cent) has a return of approximately 6 per cent even though today the market rate of interest may be 4 per cent.

D- **Gross and Net interest**. Interest actually paid by the borrower and received by the Lender is gross interest. Gross interest covers various expenses incurred by the lender in making the loan, such as clerical expenses, cost of making a credit

investigation, and the like. What is left when these costs are subtracted from gross interest, is net interest.

1-1. Effects of Risk on Interest

Net interest rates tend to vary with the risk taken by the lender. This risk is twofold:

1. Risk of nonpayment of the loan. This is sometimes called the default risk. Loans to the federal government (government bonds) are practically risk-free.
2. Risk of fluctuation in the market value of the obligation (e.g., bonds) due to changes in the market rate of interest. This is sometimes called the money market risk.

1-2. Variety of Market Rates of Interest

There are many different rates of interest in the market, not just one. This is due to:

(1) the different degrees of risks attaching to various loans (securities)

(2) the different costs of making loans

(3) custom, especially where competition among lenders is restricted (e.g., real estate mortgage Loans) and where borrowers are had pressed (e.g., pawnshop loans).

1-3. Interest Determined by Supply and Demand for Funds.

Like any other price. Interest can be regarded as being determined by the interaction of supply and demand. And since interest is the price paid for funds, it is the demand for funds and the supply of funds that is here considered.

1-3-1. Supply of Funds

Funds are offered to borrowers by:

(1) private individuals who have saved or received funds through the sale of assets, inheritance, or borrowing

(2) business firms whose receipts exceeded their outlays

(3) financial institutions, such as savings banks. Which act as middlemen between individual lenders and borrowers

(4) governments

(5) commercial banks, which are the creators of all funds and from which all other lenders must directly or indirectly obtain their funds.

1-3-2. DEMAND FOR FUNDS

Funds are held , or borrowed, by individuals, firms, and governments for a variety of reasons or purposes which can be summed up under three headings;

1. **Transactions.** Funds are needed to make purchases. Individuals or firms or governments may want to spend temporarily in excess of their receipts.

2. **Precaution**. Individuals, firms, governments want to have funds on hand to meet unforeseen expenditures.
3. **Speculation**. People and firms sometimes want to hold funds because they expect interest rates to rise. If this happens, the holders of funds can later lend them out at higher interest rates.

2- RENT

2-1. Definition

Rent (that which is rendered, a return) may be defined either as (1) the price paid for the right to use a repeated-use good (land, houses, machines, etc.) over a stated period .

(2) the income derived by the owners of repeated-use goods from the employment of these goods, whether by themselves or by others .

2-2. Contract Rent

As a price paid by one person to another, rent is the result of an agreement or contract. The rent payment agreed upon is called contract rent. The recipient of the rent payment is the lessor or, in the case of real estate (land, buildings), the landlord; the person who pays rent is the lessee or, in the case of real estate, the tenant.

Rent contracts usually stipulate the price to be paid for the use of a repeated-use good for a period of time, e.g., a week, month, or year. A written agreement to continue to pay a specified rent for more than one weekly, monthly, or yearly rental period is a lease.

2-3.**Economics rent**

is sometimes defined as the excess or surplus income which a unit of any factor of production yields over the amount necessary to secure its services.

2-4. Quasi-Rent

Land yields rent because the supply of land is in-elastic. If additional land could be produced as demand for it increases, economic rent would disappear. This is the case with buildings, machines, and other durable capital goods: The quantity of such goods can be increased to meet increased demand for them; consequently they do not yield economic rent.

2-5. **Rent and Prices**

High or low rents are caused by high or low prices, but they do not cause prices to be high or low. When the price of cotton is low, the planter may be barely able to pay taxes, wages, and other costs including the costs (depreciation and interest) of his capital investment, with no economic rent left over. As cotton prices rise, while labor and capital costs remain unchanged, the

economic rent yielded by the plantation increases. The rent of cotton plantations reflects changing cotton prices.

3-PROFIT

3-1. Definition

Profit is the income accruing to owners of firms by virtue of such ownership. It is distinct from interest, which goes to lenders of funds, and front rent, which goes to owners of land and other production goods. Alternatively stated, profit is the net income of the firm; it is the difference between the gross revenue of the firm and its costs.

3-2.Accounting Profit

Firms ascertain their profit by drawing up a profit and loss statement, or income statement, covering their fiscal period, usually a year. As shown in the statement.

Loss. Profit is the only income that can be negative, in which case it is called a loss. Firms frequently show a loss instead of a profit. Even when the profit and loss statement of a firm shows a net profit, the firm may still suffer a pure loss, instead of a pure profit, because the net profit may be smaller than the implicit costs.

3-3. Sources of Profit

1. **Chance**. Fire or flood destroying the competitor; war and similar fortuitous events may increase the profit of a particular firm.
2. **Monopoly** or imperfection in competition enables a firm to keep prices high and profitable.
3. **Underpayment of factors**. Firms may for considerable periods underpay workers, managers, and owners of other factors, thus adding to profit.
4. **Efficiency**. Some firms operate more efficiently than others. This, however, implies that the managers are superior and should be paid more. Hence the claim that efficiency brings profits is really only another way of saying that production factors are underpaid.
5. **Innovations** or inventions may give sôme firms a temporary advantage.
6. **Accounting methods**. A change in methods of figuring depreciation charges, treating advertising either as a cost or as an investment in building up the good will of the public toward the firm, and many similar procedures greatly influence profit.
7. **Price Changes.** Rising prices will tend to increase profit for most firms. Falling prices bring losses.

4-WAGES

4-1. Definition

Wages can be defined as :

(1) the price paid for the right to command personal services, or labor, for stated periods; or as the price paid for the use of labor power .

(2) the income which people obtain for performing personal services, or labor, or for placing their labor power at the disposal of others.

4-2.Meaning of "Labor."

The term "labor" as used by economists means all personal services and includes the activities of :

(1) wageworkers in the narrow sense of the term, i.e., all those who receive wages or salaries from employers

(2) professional people, like doctors and lawyers, who receive fees from patients or clients

(3) people who work in their own business.

Sometimes "labor" refers to the people who work, rather than to the work they perform; as in the expressions "organized labor" or "labor leaders."

4-3. Wage Rates

Wages are usually expressed as a rate – either so much per hour, day, or week (time rates) or so much per-unit of work

performed (piece rates). Time rates are the most prevalent; but piece rates are also widely used. Many working people object to the piece rate wage because it pits the workers against each other and has often been used by employers as a device to speed up work.

4-4. **Wages, Earnings, Payrolls**

Wage rates may rise at the same time that a worker's daily or weekly wage decreases, and the other way around. This is because he may work fewer (more) hours or days. Similarly his weekly wages may increase (decrease) while the sums of the weekly wages of all workers may decrease (increase) because fewer (more) people are employed. To differentiate wage rates from the wage income actually received by the worker and from the sum of wage payments made by employers, the following terminology is widely used:

Wages = wage rates (hourly or daily or piece rates).

Earnings = wage earned by individual workers (daily, weekly, etc.).

Payrolls = sum total of wage payments.

4-5.**Money Wages and Real Wages**

Money wages or nominal wages are wages expressed in money. Real wages are the goods that can be bought with money wages. If money wages rise but prices of consumer

goods rise in the same proportion, real wages are unchanged. If prices change but money wages do not change, real wages change in inverse proportion to the change in prices. Changes in real wages can be measured by dividing money wages by an index of consumer goods prices.

Chapter 8

National Product and Income

8-1. Definition

The real income available to the people of a Community over a given period, such as a year, consists of the goods and services Produced during that period .

Gross National Product (GNP)

The value of all the final goods and services produced in the economy. Final and Intermediate goods:

1- **Final goods and services** are goods and services that are not used as inputs in the production of other goods and services but are bought by their final user.

2- **Intermediate goods and services:** used as inputs into the production process of another good or service. I.e. tuner for printers.

GNP: is the major source of improvements in living standards.

The nation's total output is measured by gross national product. Gross national product is the dollar value of all the

goods and services produced in the economy in a given time period.

8-2. OUTPUT OF FIMRS

The greatest part of gross national product is produced by firms. The value of the goods produced by firms can best be determined by actually selling the goods, since value, or price, depends ultimately on what consumers are willing and able to pay. Gross product of firms, then, is arrived at by adding the sales of all firms. To these sales must be added the value of the goods produced during the year but not yet sold. And a corresponding deduction must be made for goods sold during the year, but produced in a previous period.

8-3. OUTPUT OF HOUSEHOLDS.

Not all goods are produced and sold by firms. Some are produced by individuals for their own consumption. Farmers, for instance, directly consume a part of their output; some people build their own houses and do their own maintenance and repair work; housewives labor around the clock, cooking, washing, and sewing. All these services are really a part of gross national product, but in practice most of them are not included. Specifically, the work of housewives and maintenance and repair work done by owners are not counted

because there is no practicable method of ascertaining the quantity and value of such services.

8-4. OUTPUT OF GOVERNMENT

Another important contribution to gross national product is made by governments, which provide administrative. Judicial, and a wide range of other services. Some goods produced by government are sold; for instance, postal services. But most goods and services produced by government are not for sale. Yet they are valuable and contribute to the wealth of the community. This is sometimes doubted with respect to some government activities, but no one denies that road maintenance, or the services of police and fire departments, to mention only a few examples, are essential and productive.

Since these services are not sold and consequently cannot be included in gross national product at their market value, they are counted at cost. That is, what governments spend on police, army, administration, and other services is regarded as the value of these services.

8-5. Net National Product (NNP)

Gross national product is produced with the aid of capital. Much of this capital was produced in previous periods and some of it was used up in producing current output. To arrive at the output attributable to productive effort during a

particular year (or other period), the value of capital currently consumed must be deducted from gross national product. What is left is called the net national product.

NNP = GNP – capital consumed

8-6. National Income (NI)

Gross national product and net national product are arrived at by adding up the market values, or selling prices, of all goods and services produced; or the expenditures made for purchasing these goods and services. An alternative method of measuring total output and income is to count the costs of producing these goods and services. Costs of production are the payments to the owners of production factors. Payments to the people who own production factors are the same thing as the factor incomes which these people get under the designation of wages and salaries, interest, and rent.

If profit is included as a cost, or factor cost, total factor cost must equal the value of output. The value of net output, or net national product at factor cost, is called the national income.

Conversely, government sometimes pays subsidies to firms. These subsidies do not change the value of the firms' output, but nevertheless accrue to the owners of the firms as income and must therefore be added to net national product in order to arrive at national income.

N1 = NNP – indirect business taxes + subsidies

8-7. Personal Income (PI)

Factor costs, as defined above to include profits, are equal to factor incomes, but not to incomes actually received by individuals, or personal income. Two deductions must be made from, and one addition to, national income to arrive at personal income.

The first deduction is for social insurance contributions. These payments are made only in connection with production and are therefore properly regarded as costs of production. The second deduction is for the portion of corporation profits which is not paid out to stockholders.

8-8. Disposable Personal Income (DPI)

Not all of their income is at the disposal of the recipients. Government compels them to give up a part in payment of income taxes and other personal taxes. Only what is left to individuals after they have paid their personal taxes is disposable income.

DPI = PI – personal taxes

Individuals can dispose of their incomes in two ways: they can either spend on consumption or save, which means not to spend on consumption.

DPI = personal consumption + net personal saving.

Chapter 9

Money theory

9 – 1 . What is Money ?

money is any commodity or token that is generally acceptable as the means of payment. A means of payment is a method of setting a debt. When a payment has been made there is no remaining obligation between the parties to a transaction.

Money is a medium of exchange.

A medium of exchange is anything that is generally acceptable in exchange for goods and services. Without a medium of exchange, would be necessary to exchange goods direct for other goods. An Exchange is Known as barter.

Barter: is the direct exchange of goods for goods. (exchanging flats or stores)

9-2. Characteristics of Money

1. Acceptability: means accepted Y people as a mean to pay for buying and selling.
2. Durability: Money needs to be long-lasting.
3. Divisibility: could be divided into small units. i.e. 1 LE = 100 Piaster.
4. Stability: The maintenance of value over time.

5. Uniformity: identical in shape, size, and weight to all people.
6. Portability: money needs to be easily carried.

9-3. Forms of Money

1. Goods (or commodities)
2. Rare Objects
3. Precious metals
4. Paper money
5. Checks.
6. Credit Cards

9-3-1. Advantages and disadvantages of credit cards

- Advantages:

1. buy now, pay later
2. easier and safe shopping

- Disadvantages:

1. minimum age 18 usually.
2. interest charged, if repayment not made within the specified time. (usually 3 weeks)

9– 4 . Early form of Money

1. **Goods (or commodities)**

As the scale of trade developed, an easier method of exchange was needed within communities, goods with some intrinsic value to the people were used. Some goods were usually chosen because of their acceptability and stability of value. However, some goods, such as salt, cattle and tobacco, suffered from the disadvantage of variable quality are perishability.

The early American settlers in Virginia used tobacco as money for 200 years up to the mid-19th century. However, as the bales were cumbersome and people paid in the worst quality tobacco, public warehouses were provided to weigh, grade and certificate set quantities.

If trade in the communities using such goods was limited, the function of this money was as a Store of Value. However, if it was perishable then its primary function would be as a medium of exchange.

2. **Rare objects.**

Some systems developed rate objects as money. Cowrie shells and dogs' teeth, which were easily divisible into convenient units, were graded into proper monetary

systems. Although useful as a means of exchange this form of mony lacked homogeneity and was susceptible to sharp fluctuations in value, as the market could be disturbed by new finds. For instance, in the Admiralty Islands, dogs' teeth were rare until Western traders flooded the market with some imported from China, and created in flation.

3- Precious metals.

These came into use because their properties overcame the weaknesses associated with earlier forms of money. As gold and silver were attractive in appearance, fairly rare and non-deteriorating, they were readily acceptable. In addition, being portable and divisible into different standard sizes and weights, they facilitated exchange and acted as a clear unit of account.

The general shortage of such metals meant that their value was maintained over tiem, enabling them to perform as a Store of Value also. A further advantage of gold was that it was acceptable in most countries and this encouraged international trade.

4- Paper money

The popularity of gold gradually reducted its usefulness as money. Its supply did not expand quickly enough to meet its demand. Furthermore, because gold was precious it was

liable to theft. Thus people holding gold often left it for safe keeping with goldsmiths.

They received a receipt for the gold deposit, which they took back in order to collect the gold when it was needed. The use of these goldsmith's receipts developed into bank notes. Thus the goldsmiths were, (a) creating money by giving credit, (b) earning profits by charging interest, and (c) taking risks by judging the credit worthiness of borrowers.

9-5 . Basic Functions of Money

1- Unit of Account

A unit of account is and agreed measure for stating the prices of goods and services. To get the most out of your budget you have to figure out, among other things, whether seeing one more film is worth the price you have to pay, not in pounds and pence, but in terms of the number of ice creams, beers and cups of tea that you have to give up.

It's easy to do such calculations when all these goods have prices in terms of pounds and pence. If a cinema ticket costs 4 and a pint of beer in the Students' Union Costs I , you know straight away that seeing one more film costs you 4 pints of beer. If a coup of tea costs 50 pence. One more cinema ticket costs 8 cups of tea. You need only one

calculation to figure out the opportunity cost of any pair of goods and services.

2- Medium of Exchange

A medium of exchange is an object that is generally accepted in exchange for goods and services. Money acts as such a medium. Without money, it would be necessary to exchange goods and services directly for other goods and services – an exchange called barter.

For example. If you want to buy a hamburger, you offer the paperback novel you've just finished reading in exchange for it. Barter requires a double coincidence of wants, a situation that occurs when Erika wants to buy what Kazia wants to sell, and Kazia wants to buy what Erika wants to sell.

To get your hamburger, you must find someone who's selling hamburgers and who wants your paperback novel.

Money guarantees that there is a double coincidence of wants because people with something to sell will always accept money in exchange for it Money acts as a lubricant that smoothes the mechanism of exchange.

3 – Store of Value

Any Commodity or token that can be held and exchanged later for goods and Services is called a store of

value. Money acts as a store of value if it did not, it would not be acceptable in exchange for goods and services.

The more stable the value of a Commodity or token, the better it can act as a store of value and the more useful it is a money.

9-6 . Measurement of money

The total volume of money in the economy is important. Clearly, if the quantity of money in the system increases, and production is constant, this will cause inflation and the value of money.

Will fall. However, what is money?' is the subject of some dispute and there are several official definitions. The differenct measures are distinguished by their 'liquidity', i.e. how quickly they can be used to buy goods/services.

The most liquid, MO. Is termed 'narrow' money whilst the least liquid measure M5 is called a broad monetary measure.

M1 = notes and coins and private sector sight (current account) deposits. This narrow money stock has components which function both as a store of value and a medium of exchange. M3 – cash and current account holdings and deposit account balances, in the private sector. M3 – 10 per cent cash, 30 per cent current account

and 60 per cent deposit account and is a broader definition of the quantity of money in the system.

As the distinction between current accounts and deposit accounts becomes less clear, the usefulness of M1 is diminishing.

M4= M3 plus building society deposits

M5= M4 plus money market lending e.g. certificates of deposit.

Ml is the most liquid but smallest volume measure, whereas M5 is the least liquid but largest size many people treat building society deposits as money, mainly because they are a store of value.

For instance, usually LE250 can be withdrawn in cash without notice being given. However, credit cards which are a means of exchange but not a store of value, are not included in any of the definitions.

In operating economic policies, the government often utilizes a monetary target. M3 has often been chosen and governments have tried to influence its growth. However, M3 has increased much faster than the other monetary aggregates. The growth has also been above the government's targets.

9-7 . The Quantity Theory of Money

The quantity theory of money is the proposition that in the long run an increase in the quantity of money brings an equal percentage increase in the price level. The original basis of the quantity theory of money is a concept known as the velocity of circulation and an equation called the equation of exchange.

The velocity of circulation is the average number of times a unit of money is used annually to buy the goods and services that make up GDP. GDP is equal to the price level multiplied by real GDP (Y). That is:

$$GDP = PY$$

Call the quantity of money M. The velocity of circulation, V, is determined by the equation:

$$V = PY/M$$

For example, if GDP is 600 billion and the quantity of money is 300 billion, the velocity of circulation is 2. On the average, each unit of money circulates twice in its use to purchase the final goods and services the make up GDP. That is each unit of money is used twice in a year to buy GDP.

Definitions of Money. You can see that the velocity of circulation of MO increased between 1963 and 1995. In contrast,

The velocity of circulation of M4 has increased I that deregulation and financial innovation have created new types of deposits and payments technological that are substitutes for MO.

More and more people are having their salaries and wages paid directly into bank accounts and now use chéques and direct debit cards. Direct debit cards enable shops to electronically debit sums of money from your bank account. They are substitutes for chouse.

Banks also have developed better methods of cash management and need to keep fewer stocks in their valuts. Except in the 'hidden' economy where cash is the main medium of exchange.

Today more people use cheques and cards than use cash. As a result the quantity of M0 per pound of GDP has decreased and equivalently, the velocity of circulation of M0 has increased. The reason why the velocity of M4 has increased is that there has been an increase in different types of deposits, and higher interest rate on those deposits have attracted funds that were normally held as savings.

So the ratio of M4 to GDP and the velocity of circulation of M4 have increased.

The equation of exchange states that the quantity of money (M) multiplied buy the velocity of circulation (V) equals GDP. Or: $MV - PY$

Given the definition of the velocity of circulation. This equation is always true – it is true by definition. With M equal to 2, MV is equal to 600 billion. The value of GDP.

The equation of exchange becomes the quantity theory of money by making two assumptions:

1- The velocity of circulation is not influenced by the quantity of money.

2- Potential real GDP is not influenced by the quantity of money.

If these two assumptions are true, the equation of exchange tells us that in the long run, a given percentage change in the quantity of money brings about an equal percentage change in the price level.

You can see why by solving the equation of exchange for the price level. Dividing both sides of the equation by real GDP (Y) gives:

$$P - (V/Y)\,M$$

In the long run, real GDP, Y, equals potential GDP, so if potential GDP and velocity are not influenced by the quantity of money, the relationship between the change in the price level (M) M is: P – (V/Y) VM

Divide this equation by the previous one (P – (V/P) to give

P – A/M

(VP/P) is the percentage increase in the price level and (VM/M) is the percentage increase in the quantity of money. Sop this equation is the quantity theory of money. In the long run the percentage increase in the quantity of money.

Chapter 10

Inflation

10-1. Introduction

During the latter half of the 1970 the inflation rose steadily in 1980 the rate was slightly lower some of the pressure for the high inflation was coming from the cost side .

The second OPEC oil price shock was working it's way through the economy pushing the short ran aggregate supply curve up word .This supply shock was clearly being accommodated by the central bank through rapid increases . Controversy broke out on how much of the inflation was due to entrenched expectations that the inflation would continue.

Every one agreed on the goal of returning to a zero inflation if possible but there was disagreement as to the means of achieving the goal.This same disagreement would occur again if the central bank advocated a policy of rapidly reducing the current rate of usually occur along with a booming economy inflation to a much lower rate say zero if possible.Monetarists advocated breaking the inflation with monetary restraint as we will analyses they where willing to rely .

The transition from a high to allow inflationary environment Keynesians agreed that allow rate of monetary growth was a necessary condition for returning to allow rate at inflation However because they felt that phase two would be long some talked in term of five to ten-years they were reluctant to use monetary policy alone during the transition As a result, many Keynesians advocated using incomes policies a term that covers any direct government wage and price setting they hoped that such intervention would shorten phase two by helping to break inflationary exceptions

10-2. Defination of Inflation

Inflation is a persistent general increase in prices.

The result of this tendency for prices to rise is that the value of money falls. The rising prices of goods and services mean that the cost of living has increased.) If people's income did not improve, then they suffer. With this little income, purchasing of goods and services will be less.

10-3. Measurement

Inflation cannot be measured exactly, as its impact varies between people, places and times. For example:

1. Different people buy different goods-if the price of cheese doubles and price of jam remains unchanged, then people

eating cheese are affected more by inflation than people eating jam.

2. The price of goods in big towns may be lower than in remote village areas, thus people living in towns suffer less from inflation and higher cost of living.
3. In the summer months the price of fresh fruit and vegetables is much lower than in the winter, so inflation in food is relatively slower.

The official figures can only be estimates because of these variations. Averages can be calculated monthly and aggregated for yearly figures.

Measurement could be done through **(RPI) Retail price Index** Which provides a statistical method of measuring the average percentage change in the price of a set of related goods and services over a period of time.

10-4. The importance of RPI

1. information is needed for government policy-making for future forecast.
2. General indication of the cost of living. It is used as a guide to estimate wages.
3. It helps in assessing future economic prospects.

10-5. Problems of measurement

1. **Changes in the nature of goods and services** (although the price may remain the same. For instance, a 1 bar of chocolate may contain less milk and more water, and so perhaps it becomes of lower quality.) Here, comparison becomes more difficult and less clear cut over time due to the change in products.
2. **Range of households:** pattern of expenditure depend on income. If price of food raise rapidly, those who spend a higher proportion of their income on food will suffer more.
3. **Spending patterns change rapidly** ,and so the weights and items need frequent revision. Factors such as:

1) changes in taste.
2) New products.
3) Increased income may lead to spending money on necessities rather than on luxury items.

10-6. The effect of inflation on business

1. less production and more unemployment.
2. increases in food prices and rent tend to hit poor families most because they spent a higher proportion of their income on such necessities.
3. less in the balance of trade deficit.

4. Fluctuating rates of inflation make it difficult for businessmen (entrepreneurs) to predict the economic future and accurately calculate the returns on their investment. A high rate of inflation requires them to seek higher profits otherwise they may put money into less risky business.
5. Savings: With inflation, the value of savings falls and the interest rate also will fall, the matter than increases the demand for credits.(borrowers of money from banks increase)

10-7. Deflation

Inflation is frequently followed by economic **depression** when government takes measures to curb rising prices. However, the deflation dose not feature falling prices but lower output and fewer jobs. Prices are 'sticky' downward, in that the main costs of production, particularly wages, are difficult to reduce, as people have come to expect rising wages and rising prices.

10-8. Causes of inflation

1- Demand-Pull Inflation

One of the principal causes of inflation is excessive demand - 'too much money chasing too few goods'. If demand is growing faster than the level of supply, then prices will increase. Output will increase as well, as there is a shift along the aggregate supply

curve, but because supply cannot keep up with demand prices go up as well. This is shown in the diagram below:

Demand-pull inflation will therefore. To avoid demand-pull inflation you need to try to keep the economy growing at a steady, but not excessive rate - a tall order .

2- Cost-Push Inflation

Cost-push inflation happens when firms' costs go up. To maintain their profit margins, firms then need to put their prices up. In other words cost increases have pushed inflation up. Cost-push inflation may arise from various sources:

- Wage increases - wages are a major proportion of costs for many firms and so if wages are increasing, this may well cause cost-push inflation.
- Government - if the government changes taxes, this may push up firms' costs. This is particularly true with excise duties on fuel and oil. Changes in interest rates can also affect firms costs if they have borrowed significant amounts.
- Abroad - exchange rate changes can affect firms' costs, particularly if they import many of their raw materials. An exchange rate depreciation will increase import prices and may therefore increase firms costs.

The effect of cost increases is to shift the *aggregate supply* to the left. As we can see from the diagram below, this pushes up prices.

10-9. The Economic Costs of Inflation

Inflation is the overall increase in the general price level of goods and services over an extended period of time. In the economy some prices are always rising while others are falling. When the average increase in the overall price level is zero, the rate of inflation is zero, even though there are visible fluctuations in prices in the market.

The negative effects of inflation in the past have strengthened the support for increased monetary and fiscal policy. Although the central banks attempts to establish policies that minimize inflation, it is apparent to economists, elected officials and the general public that there are substantial economic and social costs incorporated with a small increase in the overall price level.

The effects of inflation are inevitable in our economy today due to both expected and unexpected rises in the price level, and are conceivable from both the New Classical and Keynesian views. Anticipated inflation is when people predict the overall price level will increase and consequently sign contracts and make

long-term plans based on higher prices in the future. These plans and contracts force those parties involved to raise their prices, and eventually many prices increase simultaneously causing inflation.

When inflation is unanticipated, people are caught off guard and the effects of inflation on our economy are more severe due to the difficulty adjusting to these increases in prices. When we look at inflation in terms of Keynesian beliefs, we find the idea of an inflationary spiral(internet). A rise in costs results in an increase in prices, which continues on to a reoccurring sequence of rising costs and resultant rising prices. These costs and effects resultant from inflation emanate from a variety of origins: the relationship between unemployment rates and inflation, the effects of inflation on output including uncertain future prices and increased risk, the distribution of income, effects of inflation on debtors and creditors.

The distributional consequences of inflation are not widely recognized, however, are still visible. Those living on a fixed income are recognized as the group most affected by small changes in inflation. As the overall price level increases, the costs of living rise, and the less fortunate are unable to continue living in the same manner.

The effects of inflation upon debtors and creditors varies as the actual inflation is compared to the expected. When making loans, creditors take into consideration the expected inflation rate over the time period of the loan, and incorporate this inflation into the interest rate. The interest rate used by creditors includes the real interest rate plus the expected inflation rate. When inflation is higher than the anticipated inflation rate, debtors benefit at the expense of creditors, paying back an amount of less value than creditors originally anticipated.

10-10. Unemployment

is the number of adult workers who are not employed and are seeking jobs. To be classified as unemployed, a person must be able and willing to work, be actively seeking work, and be without a job. Everyone who fits this description is unemployed. **The Labor force**: is the total number of employed and unemployed workers. **The Costs of employment:**

1) Loss of output and income.
2) Loss in human capital (due to the lack of skills and experience – know how)
3) Increases crime
4) Affects human dignity. Loss of self-esteem.

CHAPTER 11

OFFICIAL BUDGET

If you spend more than you earn, then you have a deficit. To cover your deficit, you have to borrow or sell off some of the things that you own. Just as individuals can have deficits, so can governments.

11-1. The government deficit

Is the total expenditure of the government sector less than the total revenue of the sector.

The governments spend on a variety of public and social programs and obtain their revenue from taxes.

Deficit will cause borrowing but deficit cannot continue to borrow.

Borrowing means that the country has to pay profits. So the solution is that the government has to decrease its expenses or increase the prices of its products and services.

A- Government

an organization that provides goods and services to households and firms, and redistributes income and wealth.

B- Revenue

the amount received from the sale of a good. Revenue equals the price of the good multiplied by the quantity sold.

C- Expenditure

the amount spent for the purchase of a good. It equals the price of the good multiplied by the quantity bought.Why taxes? Because government is responsible for the following:

1. infrastructure
2. education and health
3. to subsidize goods and services
4. to make more projects to decrease unemployment
5. to protect the country from any outside aggression.

11-2. For the government, Where to get money from

A- Taxation

1. used as a social tool to achieve the social equity and citizens needs.
2. used as an economic tool o encourage investment.
3. used as a political tool during elections to influence people to elect a certain person.
4. used to achieve some social and political goals i.e. imposing lots of taxes on the person who works in the private sector.

B- Types of taxation

1. Direct taxes: i.e. on income. One can evade it.
2. Indirect taxes: you can't evade it. i.e. sales taxation.

1- Double taxation

anyone of us pays double taxation:

i.e. 1) for the product, 2) for income.

2- Double squeeze

Government takes double taxesOn the product & on sales.

Taxation influence the consumption behavior. i.e. if there are more taxation on importing products, people will stop or decrease buying them. Here government force people to buy the domestic product.

CHAPTER 12

INTERNATIONAL TRADE

12– 1 . Introduction

The tremendous growth of international trade over the part several decades has been both a primary cause and effect of globalization. The volume of wolrd trade since 1950 has increased by twenty-fold from USD320 billion to USD 6.8 trillion. As a result, consumers around the world now enjoy a broader selection of products than ever before.

Although increased international trade resulted in tremendous economic growth across the globe – raising incomes, creating jobs, reducing prices, and increasing workers earning power – trade can also bring about certain kinds of economic, political, and social distruption.

The following will help you understand some of the fundamental economic principles behind international trade, familiarize you with some of the technical terms, and offers some insights into some of the controversies surrounding international trade.

12 – 2 . International Trade in History

Before we begin a discussion about why nations trade, it would be helpful to consider the character and evolution of trade. It is important to keep in mind, first, that although we frequently talk about trade "between nationsl," the great majority of international transactions today actually take place between private individuals and private enterprises based in different countries.

Centuries before the Industrial Revolution, which witnessed the advent of powered ships, trains, and gas-powered vehicles, merchants traveling by sailing vessels and on horseback were able to sell products in regions far away from their homes. But Industrial Era transport and communications made the exchange of large quantities of good at great distances a routine part of economic life in different countries.

Governments sometimes sell things to each other, or to individuals or corporations in other countries, but these comprise only a small percentage of world trade.

It should be noted that trade is not a modern invention. International trade today is not qualitatively different from the exchange of goods and services that people have been conducting for thousands of years.

Before the widespread adoption of currency, people exchanged goods and some services through bartering, which is the trading of a certain quantity of one good or service for another good or service with the same estimated value.

With the emergence of money, the exchange of goods and services became more efficient. But for many centuries, transactions could only occur among individuals and firms in close proximity to each other. Transactions were generally confined to distances that could be covered on foot or in caravans of horses or camels.

Developments in transportation and communication revolutionized economic exchange, not only increasing it volume but also widening its geographical scope. As trade expanded in geographic scope, diversity, and quantity, the channels of trade also became more complex. The earliest transactions were conducted by individuals in face-to-face encounters.

Many domestic transactions, and some international ones, still follow that pattern. But over time, the producers and the buyers of goods and services became more remote from each other.

12 – 3 . The Rise of the Middleman

It would have been very difficult, for example, for an English blacksmith to sell hand-made metal tools directly to craftsmen in France. But an English or French firm that specialized in the purchase and sale of tools could serve as an intermediary between the blacksmith and the craftsman, enabling both to engage indirectly in international trade

A wide variety of market actor – individuals and firms emerged to play supportive roles in commercial transactions. These "middlemen" – wholesalers, providers of transportation services, providers of market information, and others – facilitate transactions that would be too complex, distant, time-consuming, or large for individuals to conduct face-to-face in an efficient manner.

International trade today differs from economic exchange conducted centuries ago in its speed, volume, geographic reach, complexity, and diversity. However, it has been going on for centuries, and its fundamental character, which is the exchange of goods and services for other goods and services or for money, remains unchanged.

12– 4 . The Importance of Trade

National clearly trade a lot, but it is not quite obvious why they do so. In other words, why do private individuals and firms take the trouble of conducting business with people who live far away, speak different languages, and operate under different legal and economic systems, when they can trade with fellow citizen without having to overcome any of those obstacles?

To answer these questions, it is helpful to think about exports and import separately.

A- Why Do Nations Export?

Exports arc easier to explain than imports. At least since the beginning of the industrial era almost three centuries ago, countries have tended to sell things to other countries either because.

1. Individuals and firms have been able to produce more of certain goods and services than can be consumed at home, This prompted a search for foreign opportunities to sell the "excess" production; or because.
2. They have been able to sell goods or services to other countries at prices higher than the prices they can obtain at home.

In today's global economy, exporting serves somewhat different purposes for developing and industrial countries.

Although the economies of developing countries are typically not as productive as the economies of industrial countries, developing countries nonetheless produce some goods and services in amounts they are unable to use or consume at home.

For example, some developing countries produce vast quantities of agricultural products, like cocoa or coffee, which their own populations are not large enough to consume. Other developing countries produce quantities of industrially valuable minerals, like oil or iron ore that their own economies are too small or insufficiently industrialized to use.

But for many developing countries, exports also serve the purpose of earning foreign currency with which they can be essential imports – foreign products that they are not able to manufacture, mine, or grow at home. Developing countries, in other words, sell exports, in part so they can import.

Exports are also more than just and outlet for "excess" production for industrial countries. Because their economies are more diverse, industrial countries tend to:

1. Export a much wider variety of products than do developing countries, and
2. Export a larger proportion of their total production of goods and services.

Export sales help maintain high employment levels in the work forces of the United States and many other industrial countries.

B- Why Do Nations Import?

The reasons why countries import products and services from other countries are perhaps less obvious. As with exports, the purposes served by imports vary from country to country. It is reasonable to ask why a country such as the United States, with its massive and extraordinarily diverse economy, needs to buy anything from other countries.

In fact, there is only a handful of goods or services that the United states absolutely must import from other countries. With a land area spanning several climatic zones, immense natural resources, and the world's most productive workforce, the United States is able to produce, mine, or grow almost every item its citizens need to lead reasonably prosperous lives.

Yet no country today, including the United States, can be totally self-sufficient at a cost that would be tolerable to its citizens. All countries need to or choose to, import at least some goods and services for the following reasons:

1. Good or services that are either essential to economic well-being or that consumers desire are simply not naturally available or cannot be produced at home.
2. Goods or services that satisfy domestic needs or wants can be produced more inexpensively or efficiently by other countries.

For example, the United States cannot now meet its oil consumption needs exclusively through domestically produced oil;' the United States possesses only 3% of the world's total oil resources. As a result, the United States today imports 56% of the oil it consumes. Most of these imports come from Saudi Arabia, Mexico, Canada, and Venezuela.

The United States could, in theory, abandon foreign oil imports, but it would constitute a very costly step, because:

1. It is not clear that domestic reserves of oil, both those that are known and those that have yet to be discovered, could satisfy current domestic demand;
2. Even if U.S. oil reserves were adequate, generating the extra production necessary to fill the gap now filled by imported oil would be extremely costly. Many foreign countries are able to produce oil much more cheaply. Besiders, accessing the additional U.S. reserves would require many years of research and development;

3. Other energy sources – for example, coal, unclear power, or hydroelectric power – could conceivably be substituted for oil imports, but complying with the associated environmental regulations, along with the cost of producing additional energy from these sources, would be very expensive.

After all, oil currently satisfies 40% of America's energy needs precisely because other domestic sources of energy are either not sufficiently abundant to cover demand or are more expensive to exploit than oil.

Electricity produced by hydropower plants built into dams is another example of an essential resource that the United States does not produce in sufficient quantity to meet its consumption needs. The United States imports large quantities of hydropower from Canada.

It is clear that the United States will depend upon imports to meet its energy needs into the foreseeable future. This is not the same as saying that the United States has no choice but to import oil from other countries. As the preceding discussion suggests, there are alternatives. But those alternatives are less economically feasible than simply continuing to import oil from countries endowed with generous petroleum reserves. In other

words, these alternatives will often prove more costly than continuing to import from other countries.

Moreover, the United Sates and other nations choose to import many other products that, unlike oil, are not economically essential, but differ in quality or features from equivalent products made at home. One prominent example is foreign-made cars, which accounted for about 40% of all the cares sold in the United States in 2000.

Americans do not buy imported foreign cars because foreign manufacturers produce certain kinds of vehicles that American manufacturers do not; U.S. carmakers produce an extraordinary range of vehicles at a wide range of price levels.
But many Americans have concluded that Asian and European car manufacturers produce vehicles with a combination of qualitites or features that satisfy their preferences more than vehicles manufactured by U.S. carmakers.

The same holds true for much simpler products as cheese, or shoes. All of these and thousands of other items that the United States imports from other countries are still made at home, but some American consumers believe imported versions of these items offer satisfactions that American varieties do not.

The United States has almost entirely stopped producing other goods because of foreign competitive efficiency. In other words,

firms in other countries are better able to produce these goods. This is the case with many types of clothing: because clothes can be produced at a much lower cost in countries where labor is cheap, most clothes are produced in developing countries.

It is worth noting that the country where a good is produced need not be the same as the country where the corporation that manufactures and sells the good is established. Several American clothing companies manufacture most of their clothes in developing countries.

12 – 5 . Trade Specialization

Country-by-country differences in the cost of producing goods and services have a major influence on the direction and content of trade. Production costs are, in turn, influenced by national endowments of three key production inputs: labor, capital (shorthand for equipment and technology), and land and natural resources.

Goods and services that mainly require low-skilled labor can be produced at a lower cost in developOing countries because the prevailing wages for lower-skilled workers in those countries tend to be substantially less than those of their counterparts in industrial countries. Since wage levels and productivity are generally higher in the United States and other industrialized countries, it may make economic sense for certain goods and

services to be made by workers in those countries and exported to the United States, as long as the cost of transporting the goods from the developing country to the United Stated does not exceed the difference in the production price in the two countries.

12-5-1 . The Advantage of Specialization

More goods are produced at lower cost per unit. Consider these two cases.

(a) A country can produce one commodity better than another Suppose country x is able to produce a commodity better than country y and decides to specialize in producing it Country Y, however, may be able to produce another commodity better than country x. Country Y may, therefore, decide to specialize in this other product.

After specializing in producing the commodity to which each country is best suited, the countries will then decide to trade with each other. The United Kingdom for instance can produce wine but perhaps not as cheaply or in such quantities as France. France will therefore provide the United Kingdom with much of its requirements of wine in exchange for, say, high-class manufactures of Scotch whisky which are not readily available in France.

(b) A country can produce both commodities better than another country One nation may be able to produce two (or more) commodities better than another country. However, it will only produce the commodity in which its comparative advantage is greater and allow the other country to produce the other product. This is called the theory of comparative costs.

Perhaps an easy way of showing this idea is if we assume a situation where a barrister (Mr. Rumpole) is a better barrister and a better gardener than a gardener (Mr. Smith). Mr. Rumpole can earn 30,000 pa if he specializerss in being a barrister, but has to pay Mr. Smith 3000 pa for doing his garden. The benefit to Mr. Rumpole is 27000 pa (i.e., 30,000 - 3000) while the annual benefit to Mr. Smith is 3000.

On the other hand; assume that Mr. Rumpole decided to spend half of his time being a barrister and half being a gardener. He will only earn 15000 pa (half of 30000 and Mr. Smith will gain nothing from this situation. Thus we can see that both Mr. Rumpole and Mr. Smith are better off when Mr. Rumpole specializes in the job in which his comparative advantage is the greater, even though he is absolutely better in both jobs.

Let us now examine this idea in relation to two countries, country X and Y, which can commercially produce two commodities: cars and freezers.

Output per person per week

	Cars	freezers
Country X	1	2
Country Y	3	4

It can readily be seen that country y has the absolute advantage in producing both cars and freezers. The problem is however, which product each country gives up if it specializes in producing either cars or freezers.

	Cars given up to pro- Duce one freezer	freezers given up to produce one car
Country X	1/2	2
Country Y	3/4	1 1/2

In this situation country X has the comparative advantage in the production of freezers because, to produce one freezer country X has to give up half a car, whereas country Y has to give up three-quarters. It is better, therefore, for country X to produce freezers rather than Y because in doing so it loses less (i.e., the opportunity cost is less). Country Y will produce the Cars.

After deciding in which commodity they have a comparative advantage, each country will specialize in the production of that particular product. The production of both cars and freezers will, therefore, increase, trading will take place and people in both countries will enjoy a better standard of living.

12-5-2 . Criticisms of the Theory of Comparative Costs

As with many other economic ideas, there are criticisms to be leveled at this theory.

(1) It is much more difficult, in the real world, to decide in which goods countries have a comparative cost advantage. This is because there are a large number of goods and many countries.

(2) The theory ignores political differences between countries which exist from time to time.

(3) The theory ignores the arguments in favor of protection.

(4) It ignores the effects of transport costs. For instance, Australia might specialize in cars and the United Kingdom specializes in freezers. However, once transport costs are added any comparative advantage my be lost.

(5) The theory assumes that if country X wants to specialize in producing more freezers it can be so easily by trasfering factors of production into freezer production. However, it may be difficult to easily transfer these

factors from cars to freezer production. In addition, car workers would have to be retrained to produce freezers.

12-6 . The advantages of International Trade

The following arguments are often put forward in favor of international trade (or free trade).

1- A Country can produce scare commodities but not others

2- A larger Market and Economics of Scale

International trade means a larger market for home-produced commodities. Because of the larger market, commodities can be produced on a larger scale. The economies of scale can be enjoyed.

3- Competition and Efficiency

International trade leads to more competition and more efficiency.

4- Political and Friendship reasons

This argument suggests that countries will have more understanding and sympathy towards countries with whom they trade. The idea is that if, for example, the Russians and Americans trade with each other there is a greater possibility that they will become friendlier towards each other. This argument is ofter put forward in favor of international sporting events, such as the World Cup or the Olympic Games. Conversely, whenever

countries have bad relations they normally restrict trade between each other.

5- Increased Value of Output

All of the arguments in favor of international trade mean that the value of a country's output (and world output) increases and citizens will enjoy a better standard of living.

Despite these arguments in favour of international trade, governments often restrict international trade by imposing protective measures.

12-7 . Method of Protection

There are several means of protection used to restrict trade between countries. Some of these means are the following:

1. Tariffs (import duties of Customs Duties)

They represent types of taxes placed on imports in a given count. Tariffs are of several kind:

(a) Ad-valorem' tariffs. This is a tariff based on a percentage of value. For instance, a 10 % tariff on an import worth 300 would raise 30, making the selling price 330 for the good. On an import worth 400 the tariff would raise 40, making the selling price 440 for the good.

(b) Specific tariff. This is a tariff based on an amount per unit. For instance a 20 tariff might be imposed whatever the price or quantity of the import.

Tariffs therefore serve two main purposes: to raise revenue for the government and to raise the price of imports, which might lead to fewer imports being purchased.

2. Import Quotas

This is a restriction on the quantity of a good which can he imported. This is a more certain way of restricting imports but it does not raise revenue. It is preferable to use quotas rather than tariffs in an attempt to reduce imports when demand for the import is inelastic.

3. Subsidies

These are made when home producers are subsidized (or given finance) which allows them to sell at a lower price than the import price. Thus when importers endeavor to compete with domestic producers they will find that their prices are more expensive and demand will be lower for the imported commodity.

4. Exchange controls

When United Kingdom importers purchase foreign goods they normally have to pay the foreign exporter in the currency of the exporter. The Bank of England can control how much foreign currency is available and can therefore restrict imports, if it so wishes, by restricting the amount of foreign currency. Exchange

controls were abolished in the United Kingdom in 1979 but are still used by some countries to control the level of imports.

5. Embargo

This is a straightforward ban on trading with another country possibly due to poor international relations. These are usually of short duration, caused by acute political differences, but occasionally are of long standing.

6. Discrimination

This is discrimination by the domestic government in favor of home produced commodities.

7. Health and Safety Regulations

These may be designed to keep out imports.

8. Voluntary Export Restraint Agreements

This is an agreement between two countries to limit exports to each other.

12-8 . Why are Trade Restrictions Introduced?

After we have examined the methods of protection, we need to know the reasons why such protection may be introduced. Some of these reasons follow:

1. To Correct a Balance of Payments Deficit

This occurs when more money flows out of a country to pay for imports than flows in the form of receipts for exports. A balance of payments deficit is therefore seen as undesirable and

protection may be introduced to correct it because protection will discourage imports.

2.to protect infant industries

when industries are being set up they need protecting from established world competition without this protection the new infant industry would decline.

3.to protect both declining industries and jobs

In United Kingdom some industries such as textiles, steel and shipbuilding are in decline. It is often argued that these industries need the protection of the state or they will decline further and cause high levels of unemployment.

4.to prevent 'dumping"

'Dumping' occurs when a foreign producer deposits its surplus production at very low prices on other countries. This will have a bad effect on the industries of the importing country, causing unemployment since people will tend to buy the cheap imports .

5- **To protect 'key' industries**

Some industries are so vital to the wellbeing of the economy that they cannot be allowed to decline. For instance, if there was another war the United kingdom would need to rely on its agriculture and steel industries.

Thus these industries need protection from imports. Also, it may be inadvisable to depend on other countries entirely for

supplies of certain very important commodities such as coal or steel.

12-9- Criticisms of protection

(a) Protection means that there is no free trade The advantages of international trade are, therefore, lost.

(b) Protection might not work in correcting a balance of payments deficit Tariffs might be imposed to prevent imports. However, if people still purchase these imports because they have inelastic demand, then the balance of payments will not improve.

(c) Other countries may retaliate If country X imposes restrictions on the imports of goods from other countries. Then these countries might in relaliation impose restrictions on the exports of country X. Again the balance of payments of country X will not improve.

(d) Inefficient industries are protected Declining and infant industries may become used to being protected by tariffs from overseas competition. The industries may, therefore, make no attempt to become efficient knowing that they are in a safe position.

12-10 . Terms of Trade

1- The meaning of the terms of trade

This is the rate at which one country's goods arfe exchanged against those of other countries. This is usually assessed by comparing index prices of imports and exports. A country is said to have a favorable movement in its terms of trade if:

(a) export prices are rising faster than import prices,

(b) export prices are falling slower than import prices;

(c) export prices remain stable whilst import prices fall;

(d) Import prices remain stable whilst export prices rise.

A favorable movement in its terms of trade means that a country is able to buy more imports with the same amount of exports.

2- Measuring terms of Trade

The method of measuring terms of trade makes use of two important index numbers, the index of export prices and the index of import prices. The terms of trade will be given a numerical value equal to: Index of average export prices x100

The terms of trade in the base year will be equal to 100. If terms of trade improve the index number will increase above 100. If terms of trade deteriorate the index number will fall.

The terms of trade for his country have therefore improved compared to the base year since the index number is now above 100.

12-11. What Determines a Country's terms of Trade?

This is determined by movements in its export and import prices. These, like all other prices, depend on the interaction of supply and demand. Thus if demand for country X's exports increased, the price of its exports will increase and its terms of trade would improve. On the other hand, if country X increased its demand for its imports then import prices would rise and its terms of trade would decline.

12-12. The relationship between the terms of trade and balance of payments

It is worth nothing at this point that the terms of trade are not the same as the balance of payments or the balance of trade.

It is easy to assume that since a country's terms of trade are improving the balance of payments for that country must also be improving. However, there are a number of qualifications to be made before we can reach this conclusion.

A great deal depends on the elasticity of demand for exports and imports. If demand for exports is elastic then an improvement in terms of trade might have a bad effect on balance of payments. This is due to the fact that if prices of

exports increase, total exports decline in volume and consequently the value of exports decline.

However, if demand for exports and imports is inelastic then an improvement in the terms of trade should improve a country's balance of payments.

If country X's terms of trade have improved then terms of trade of some other countries must have declined. These other countries may not be able to afford to purchase country X's export of goods and services and again the balance of payments of country X would deteriorate.

12-13. The balance of payments

A – The meaning of balance of payments

The balance of payments is a record of transactions between countries involved in international trade. It is a record of receipts from exports (sales of goods and services abroad) and inflows of capital investment, and spending on imports (purchases of goods and Services from foreign countries) and outflows of capital investment.

If a country's receipts are greater than its spending then it will have a balance of payments surplus. If a country's receipts are less than its spending, however, it will have a balance of payments deficit. A surplus is preferred to a deficit because it

means that the country is earing more from exports than it is spending on imports.

B – The balance of payments accounts

1 – The current account

The current account is divided into two parts

(a) Visible trade: This includes the value (i.e., price *volume) of imports and exports of goods. The difference between these is termed the balance of (visible) trade. This figure must not be confused with terms of trade (see previous section) or the balance of payments proper.

(b) Invisible trade This includes the value (i.e., price * volume) of imports and exports of services. Such services would include aviation, interest, profits and dividends, shipping, tourism, banking and insurance, government services and private transfers.

The balance of visible trade is taken together with the balance of invisible trade to give current account balance.

2- Investment and other capital flows

This is a record of inflows of capital investment into the country's economy and out flows of capital investment out of the country's economy. An inflow is regarded as a positive (+) item and an outflow is a negative (-) item. Investments can be either long term or short term. The

latter are often termed 'hot money' because they constitute capital which can, he moved easily.

3- The balancing item

This represents mistakes and omissions in the figures. The banks know the real values since they handle currency movement. A (+) balancing item means that more currency has entered the United Kingdom than estimated. A (-) balancing item means that less currency has entered the United Kingdom than estimated.

4- The balance for official financing

When current account balance, investment and other capital flows and balancing items have been calculated, the balance for official financing is calculated by adding these figures together. If the balance for official financing indicates an inflow of money, this is a balance of payments surplus, if the balance for official financing indicates an outflow of money; this is a balance of payments deficit.

12-14. Official financing

Every penny of a deficit must be financed by borrowing or running down reserves of gold an foreign currency held at the Bank of England. Borrowing usually takes place from the international Monetary Fund (IMF). Likewise, every penny of a surplus must be allocated to paying off previous loans or added

to reserve, of gold and foreign currency. Official financing ensures that the balance of payments always balances (on paper at least).

12-15.Exchange rates

1 – Why exchange rates are necessary

An exchange rate is a country's currency expressed in value in terms of other currencies. For instance, the pound sterling is equal to 1.5 Us dollars. If you look in the Financial Times on any one day it will give the exchange rate of the pound.

Exchange rates are necessary because when a country sells commodities abroad it normally wants its own currency for those exports in order to pay its workers and shareholders.

For instance, if the United Kingdom exports commodities abroad it will require pounds sterling. Thus importers of United kingdom goods need to buy sterling on the foreign exchange markets. As we shall see later, the exchange rates need not remain fixed from day to day.

2-Methods of organizing exchange Rates

A- The gold standard

This was employed in the international economy before 1914 and was briefly restored between 1925 and 1931. Gold was used as the main means of payment for trade between countries (i.e., as a trading currency) and also as a

means for countries to held their national wealth (i.e., as a reserve currency).

It still fulfils these roles but it now shares them with pounds sterling, US dollars and Special Drawing Rights. Gold is no longer as important as a trading unit. Gold was used because all countries had confidence in its value and it was accepted everywhere. All currencies had an exchange rate in terms of gold, and gold could easily be imported and exported. Moreover, the size of money supply was based on how much gold a country had.

1-The advantages of the gold standard

(a) Balance of payments automatically corrected themselves. If a country experienced a balance of payments deficit this meant that gold had to be exported to pay of it.

The country would therefore have less gold, which would mean less money supply and a deflationary policy. Prices and incomes would be restricted, making exports more desirable because they are cheaper and imports less desiable because they are cheaper and imports less desirable because they are dearer. The balance of payments is thus remedied automatically as exports increase and imports decrease.

(b) There is no danger of too much inflation. Because the money supply was based on how much gold a country possessed, if would not be able to oversupply money, which would cause too much demand and inflation

2-The disadvantages of the gold standard

(a) If a country had a balance of payments deficit at the same time as a high level of unemployment, operation of the gold standard would worsen unemployment. A deficit would cause gold to leave the country and reduce money supply. Demand in the economy would decline causing even more unemployment.

This happened in 1926 and the employers tried to reduce wages to improve exports. This caused a General Strike among workers throughout the United Kingdom.

(b) In the modern world economy there is not enough gold to finance the volume of world trade. This is called the liquidity Problem therefore gold has been joined by dollars, pounds and Special Drawing Rights to finance world trade.

(c) Most of the gold in the world, yet to be mined, is owned by South Africa and the USSR. Any restoration of the gold standard would give these countries a great deal of power in the world economy.

Because of these disadvantages, gold is unlikely to be restored as the main means of determining exchange rates and financing world trade.

B-Fixed exchange rates (managed flexibility)

Fixed exchange rates existed in the international economy between 1944 and 1971 and were supervised by the International Monetary Fund. The system worked by fixing exchange rates between currencies and it was the responsibility of countries to make sure that exchange rates remained fixed.

For example in the United Kingdom the pound was fixed by two methods: (It was also referred to as a system of managed flexibility because some flexibility was allowed between very narrow limits. Somethimes it is called the adjustable-peg mechanism)

(a) Intervention The Bank of England, as agent of the government, on its exchange equalization account would purchase pounds if the pound was falling in value, (due to a balance of payments deficit perhaps) or sell pounds if the pound was rising in value (perhaps because of a balance of payments surplus).

(b) Exchange controls the Bank of England would control how much foreign exchange was available to people who

wanted to purchase it. This would control the supply of pounds, which would be offered to buy foreign exchange.

1- Advantages of Fixed Exchange Rates

The advantages include.

(a) World traders always knew what the exchange rate would be for any currency. This gave them confidence to enter into long term, contracts and give credit. It therefore encouraged more trade.

(b) It prevented any speculation in currencies. Speculators in a floating exchange rate system might force a currency's value up or down to make profits. Speculation is prevented by a fixed exchange rate system.

(c) Balance of payments deficits would have for to be paid for. Since the currency could not be allowed to decline in value (as it would on floating exchange rates) the deficit would he paid for out of reserves of gold and foreign currency. To avoid these being diminished altogether, the country would have to do something to prevent the balance of payments deficit, such as deflation or protection.

2- Disadvantages of Fixed Exchange Rates

(a) Any balance of payments deficit would mean that strains would be felt on gold and currency reserves or borrowing

would have to take place. Thus unpopular policies might have to be introduced such as deflation, protection or devaluation.

(b) The fixed exchange rate system was seen as too inflexible.

C – Floating, Fluctuating or Free Exchange Rates

These have been in operation in the world economy since 1971 (although not in their purest from because governments often wish to influence exchange rates).

The present system is referred to as dirty floating because the government will always interfere if the exchange rate falls (or rises) too much Under this system the value of a currency is determined by its supply and demand.

If the currency is in demand due, perhaps, to a balance of payments surplus (it is needed to pay for the country's exports) the exchange rate will rise.

1- Advantages of Floating Exchange Rates

A balance of payments deficit is automatically corrected by a change in the exchange rate. For instance, assume the United Kingdom makes a balance of payments deficit. This means that demand for foreign currency (to pay for imports) is greater than demand for pounds (to pay for United Kingdom exports). The pound will fall in value making United Kingdom exports cheaper

and imports more expensive. Consider the following example to prove this

Before devaluation: 1 = 4 dollars

After devaluation: 1 = 2 dollars

An American firm sells a good to the United Kingdom worth 4000 dollars. Before currency depreciation the Untied kingdom importer had to pay $E2000. therefore, imports would fall because they have become more expensive. Further assume that a United Kingdom export sells for 1000.

Before depreciation usd4000 had to be paid for the export. After a depreciation of usd2000 would have to be paid for the same export, assuming elastic demand for exports and imports, the value of exports will rise and the value of imports will decrease. Thus a balance of payments deficit is corrected automatically without deflation, protection or strains on reserves of gold and foreign currencies.

2- Disadvantages of Floating Exchange Rates

(a) There is a great deal of uncertainty in world trade about exchange rates, which may be changing on a daily basis. Traders might be reluctant to enter into long term contracts or grant credit. There may he a bad effect on the volume of world trade.

(b) Speculators can force the exchange rate up or down to make profits for themselves.

(c) Governments may come to the conclusion that any baialnce of payments deficit will be automatically corrected by a fall in the exchange rate. Thus the government's economic policies may be too expansionary causing too much demand and inflation. There could be economic mismanagement by the government.

12- 15 . Balance of payments surpluses and deficits

What are balance of payments deficits and surpluses? What could cause these states of affairs? Is it good or bad to have a deficit or surplus? If it is bad to have a deficit (or surplus) on the balance of payments, how can it be eliminated?

A- Balance of payments deficits

A balance of payments deficit occurs when a country spends more on imports of goods and services than it receives in receipts.

Possible Causes of a Deficit

These causes can be summarized as follows:

(a) A high price of home-produced goods and services making exports expensive and imports cheaper.

(b) A high value of the country's currency, again making exports expensive and imports cheaper.

(c) A poor quality or low quantity (perhaps due to strikes) of home-produced goods and services, also poor after-sales service.

(d) Too much domestic demand which sucks in' imports.

Why is a Balance of Payments Deficit Considered to be Undesirable? For several reasons:

(a) A deficit usually indicates that the economy is in a poor situation, depending on the particular cause. It could mean, for instance, that inflation is present in the economy.

(b) A deficit might mean that reserves of gold and foreign currency have to be run down to pay for the deficit.

(c) Loans to pay for the deficit (for example, from the IMF, may have to be made and, in future, repaid with interest.

(d) Unpopular measures, like deflation and protection, might have to be introduced to solve the problems causing the deficit.

Curing a Balance of Payments Deficit

A balance of payments deficit can be automatically solved with floating exchange rates by a fall in the value of the currency's exchange rate. However, on a system of fixed exchange rates the following measures might have to be taken to cure the deficit:

(a) Borrowing from the international Monetary Fund (IMF).

(b) Imposition of tariffs and other measures of protection.

(c) Deflationary policies Deflation means an attempt to damp down home demand, thereby keeping prices down and leading to less demand for imports and cheaper exports. Such a policy might include raising interest rates, preventing bank form creating credit, higher taxes and making hire-purchase more difficult and expensive to obtain.

(d) Currency devaluation. As a last resort, the country may have to devalue the exchange rate of its currency. As we have seen this would make imports more expensive and exports cheaper and, assuming elastic demand for exports and imports, the balance of payments should be corrected.

The United Kingdom devalued the pound in 1949 and 1967. However, there can be disadvantage in taking this course of action. Let us assume the United Kingdom devalued the pound to solve its balance of payments deficit. The devaluation might not work because:

Foreigners may not buy more United Kingdom goods even if they have become cheaper, i.e., their demand for United Kingdom exports is inelastic, other countries might also devalue their currencies and erode the advantages of the United Kingdom devaluation,

The United Kingdom might not be able to produce extra goods because of strikes etc; i.e., supply is inelastic;

Because of the higher price of imports this may cause inflation in the United Kingdom and, therefore, erode the advantages of the devaluation.

B- Balance of Payments Surpluses

A balance of payments surplus is when a country's receipts from international trade exceed payments made.

Possible Causes of a Surplus

The following are some of the causes:

(a) Relatively low prices of home-produced goods making exports cheap and imports more expensive. Thus more exports are sold and less imports bought.

(b) Goods and services being exported at the expense of the hoe market.

(c) Reducing imports by producing goods which previously had to be imported.

(d) Reduced imports due to a lack of consumer demand in the home market.

Is a Balance of Payments Surplus Always Desirable?

A balance of payments surplus is normally considered to be desirable because more money is flowing into the economy

rather than out of it. However, it could be considered undesirable if:

(a) The surplus is large and made year after year. It must mean some other countries are making deficits and these countries may have to limit their future trade. Japan and West Germany have usually had a balance of payments surplus since 1950, but they have revalued their currencies at times to reduce their surpluses.

(b) The surplus could be inflationary because it will mean money flows into the economy increasing money supply, and demand will increase, causing prices to rise.

How to Cure a balance of Payments Surplus

If the surplus on balance of payments is considered to be undesirable then the following policies might be introduced (assuming fixed exchange rates):

(a) Increase consumer demand in the home market. This will suck in imports.

(b) Revaluation of currency. Here the exchange rates of currency would be allowed to sires in value against other currencies. This would have the opposite effect to devaluation. Export prices would rise and import prices would fall. Thus fewer exports would be sold and more imports would be bought assuming, elastic demand for exports and imports.

CHAPTER 13

ECONOMIC DEVELOPMENT

13-1. Introduction

Economics always reflects the problems of the particular country and of the particular age which produces it. The prosperous 1920's produced a new economics of prosperity, depression gave birth to the Keynesian economics of stagnation, war brought a new "economics of war" with emphasis on questions of optimum utilization of manpower, allocation of resources, and inflation. After the war a problem that has claimed the attention of the world has been the problem of what can and should be done to develop the "backward" economies of poor, "underdeveloped" countries.

To the question of how wealth and welfare were to be attained, different answers were given at different times in various places. The economists of the mercantile age urged reliance on trade, the classical economists who came after them showed the need for capital accumulation. Many, even today, believe with Adam Smith that the "Wealth of Nations" can best be increased through reliance on private initiative in

pursuit of private gain. Many others are convinced that social action.

13-2. Definition of "underdeveloped countries."

The term "underdeveloped country" is vague. So is "backward country," The uncomplimentary term used until a few years ago, or "developing country" employed by some writers as less offensive still than "underdeveloped country." "Backward" and "underdeveloped" suggest that development has not progressed as much as it might have. In this sense all countries, including the United states, are "underdeveloped." What people have vaguely in mind when using such terms is a country that is poor, not civilized, and not industrialized in the same way as the "western" countries of Europe and North America. But this is inaccurate, for among the "western" countries are some that are not industrialized, yet are among the richest (e.g., Denmark), others that are industrialized, but have a low per capita income (e.g, Italy), and among the poor, non industrial, "underdeveloped" countries are many that are highly civilized.

The principal criterion of "development" is real per capita income. Countries with high per capita incomes are "advanced" or "highly developed," those with low per capita incomes are "underdeveloped."

Per capita income is also inadequate as a measure of economic development because it conceals inequalities of income. Venezuela may be classified as a "developed" country on the basis of per capita income, but this is only because a relatively few people drive high incomes from oil, while the masses of Venezuelans are as "backward" or "underdeveloped," as poor, uneducated, and miserable as the people in other Latin American countries that are classified as "underdeveloped." Economic development or growth is best measured by the rate of increase in real per capita income.

13-3. Reasons for Interest in Economic Development

(1) Foremost among the reasons for interest in this subject is the struggle between the two rival ideologies of capitalism and communism for the allegiance of the poverty-stricken two-thirds of the world's population who live in the underdeveloped countries. There seems to be a feeling that the test of which of the two systems is superior hinges on how they can help countries to develop.

(2) By helping "underdeveloped" nations to develop, the advanced nations serve not only their ideological and political ends, but also their more immediate economic interest. Advanced nations can help underdeveloped

countries by exporting capital to them. If this is done at a time when the exporting country is threatened with depression, this aid to underdeveloped countries can also be the means of saving the advanced economy from collapse.

(3) The poverty ridden two-thirds of the world's population that inhabit the underdeveloped countries of Asia, Africa ,and south America, are stirring. They are determined to throw off colonial exploitation; they want an end of starvation, poverty, and diseases; they want to share in the better life made possible by modern technology; they want to develop industry, improve their agriculture, and they urge their demands through the United Nations and in other ways.

(4) Industrial development of these "colonial." "backward," or "underdeveloped" regions is all the more urgent because of the rapid growth of population. Up to now these people have benefited from modern technology chiefly in the form of improved health standards that have reduced their death rates. They have not yet developed methods of keeping their birth rates down, or of increasing their output to feed the growing population adequately.

(5) Self-interest on the part of the advanced countries, and insistent calling of attention to their problems by the underdeveloped countries themselves, have probably aroused also the nobler feelings of people in the more fortunate countries, The thought that while we waste food, hundreds of millions of men, women, and children go hungry and never have an adequate meal, is uncomfortable.

13-4. Reasons for "backwardness."

Why are countries "underdeveloped"? what are the characteristic features of conditions of such as countries?

(1) ***Population.*** One basic reason for "backwardness" is overpopulation. In underdeveloped countries there are so many people in relation to available resources that the people are barely able to eke out a living with their primitive production methods. The health of the people is poor, their physical strength and energy low, and this contributes to making their productivity low. Productivity is further impaired by the low level of education and the lack of skills, This makes improvement in production methods difficult.

(2) **Resources.** Underdeveloped countries generally are poorly endowed with natural resources. Where

valuable natural resources do exist, as the oil in the Arab countries, Venezuela, and Iran, they are mostly exploited by foreigners for their own benefit. Instead of being used as a basis for domestic industry redounding to the benefit of the native population.

(3) **Consumption and Production.** Most of the income of people in underdeveloped countries is spent on food.

Production necessarily reflects this consumption pattern. Agriculture is the dominant industry, absorbing 70 to 80 percent of the population. There is little manufacturing; transportation facilities are few and crude. One of the difficulties of underdeveloped countries is that manufacturing industry cannot develop unless there is enough food for the industrial population, but food production claims most of the labor force.

(4) **Saving**. Accumulation of capital, necessary it productivity and levels of living are to be raised, requires saving. But poor countries cannot save much. Precisely because they are poor. Incomes being barely sufficient to maintain life, the propensity to consume must be high, and the propensity to save correspondingly low.

13-5. Policies to Encourage Economic Development

In many underdeveloped countries, government and people believe that their poverty can be alleviated. And they are determined to do something about it. The policies most likely to further economic development must vary from country to country, depending on the particular problems faced by each country.

But, in a general way, the necessary policies are suggested by the preceding analysis of the conditions which characterize "underdeveloped" countries and which must be remedied if economic progress is to be achieved. They may be summarized as follows:

1. Social and political institutions must be introduced and furthered which will encourage effort and self-improvement. Specifically, the stifling feudalism still widely prevalent must be removed. Hostility to economic development must be overcome.
2. Public education and health must be furthered in order to develop and intelligent and competent work force.
3. Population growth must be restrained, otherwise all technological advance will tend not so much to raise

the level of living and to lift people out of their misery as to spread the misery over larger numbers.

4. Investment in productive equipment in manufacturing, mining, agriculture, transportation. Power must be encouraged.
5. Saving must be encouraged. Though the objective of economic development must be to raise the level of consumption, the first efforts must necessarily be directed toward capital formation which will provide the source of larger income and a higher level of living.
6. Agricultural production must be modernized.
7. A fiscal program must be devised and other government action taken to further and support all these objectives.

CHAPTER 14

SUSTAINABLE DEVELOPMENT AND GLOBALIZATION

14-1.What is Sustainable development?

Is the simple idea of ensuring a better quality of life for everyone, now and for generations to come. A widely used international definition is "development which meets the needs of the present without compromising the ability of future generations to meet their own needs".

The idea means meeting four objectives at the same time, in the world as a whole:

- Social progress which recognizes the needs of everyone;
- Effective protection of the environment;
- Prudent/careful use of natural resources; and
- Maintenance of high and stable levels of economic growth and employment.

14– 2 . Why Do We Need Sustainable Development?

Because the need for development is as great as ever, but future development cannot simply follow the model of the past. This is true for the world as a whole, and for every community in a country.

The global picture is striking. A quarter of the world's people has to survive on incomes of less that usd1 a day. A fifth have no access to health care. Huge though the challenge may seem, it is becoming larger: the world's population will increase by half, another three billion people, by 2050.

Some countries do not have problem's on such a scale. But they cannot stand aside from these issues. Global prosperity must increase, and be more widely shared.

Economic growth remains vital for a better quality of life: for education, healthcare and housing, to tackle poverty and social exclusion, and to improve standards of living through better goods and services.

We need greater prosperity with less environmental damage. We need to improve the efficiency with which we use resources. We need thriving cities, towns and villages based on strong economies, good access to services and attractive and safe surroundings. And we need international co-operation to overcome environmental problems, to allow trade to flourish and to help the world's poorest people as we move towards a more global society.

14– 3 . A Strategy for Change

This is the challenge of sustainable development. For the future, we need ways to achieve economic, social and

environmental objectives at the same time, and consider the longer-term implications of decisions.

We have to spread best practice, and build on what has already been achieved. Sometimes solutions will be obvious, such as not allowing land to be contaminated so that it has to be cleaned up. In other cases, new approaches will be needed if we are to achieve economic growth (the sustained increase in real gross domestic product per capita) in a way that minimizes its impact on the environment:

for example, by making more efficient use of energy and of transport infrastructure.

This strategy is a catalyst for that change. It identifies priority areas for action, and indicators and targets to measure progress, against which the Government will expect to be judged.

It sets out action that the Government has already taken and further initiatives that are planned, and highlights what others can do. The Government will use the Strategy as a framework to guide its policies. It will encourage others to do the same.

14– 4 . Globalization

Globalization is a term used to describe the acceleration and intensification of economic interation among people, companies, and governments of different nations.

International commerce is not new, of course. For thousands of years, people, and later corporations, have been buying from and selling to people in lands at great distances.
For centuries, people and corporations have invested in enterprises in other countries. But policy and technological developments of the past few decades have increased cross-border trade, investment, and migration so large that many believe the world has entered a qualitatively new phase in its economic development.

Since 1950, the volume of world trade has increased by twenty times. And from just 1997 to 1999 flows of foreign investment nearly doubled, from usd468 billion to usd827 billion. Globalization is the name they have given to this unprecedented growth of global economic activity.

Globalization has been driven by policies that have opened economies domestically and internationally. In the years since World War II, and especially during the part two decades, many governments have adopted free-market economic systems, vastly increasing their own productive potential and creating endless new opportunities for international trade and investment. Governments have also negotiated dramatic reductions in barriers to each other's commerce, further stimulating international trade and investment.

king advantage of new opportunities in foreign markets, corporations have built foreign factories and established production and marketing arrangements with foreign partners.

Technology has been the other principal driver of globalization. Advances in computer and communications technology, in particular, have dramatically transformed economic life.

Computers and other digital technologies have vastly increased office productivity, facilitating the rapid exchange of documents, research, collaboration with far-flung partners, and the collection and analysis of data information and communication technologies have given all sorts of individual economic actors – consumers, job seekers, recruiters, professionals – valuable new tools for identifying and pursuing economic and business opportunities.

They have enabled companies to disperse their operations around the globe, and to manage more effectively their production processes and inventories.

Most agree that globalization is a phenomenon of great promise. The expansion of international commerce offers more of the world's people, including the poorest, opportunities to improve their economic fortunes. The economic growth induced

by globalization has lifted hundreds of millions of people out of poverty over the past few decades.

But globalization offers no guarantees. Bad policies can leave entire countries, or large portions of a country's population, on the sidelines of the world economy. Most of the world's people still have only limited access to the technologies that are turning industrial economies into "information economies".

There is a risk that large portions of the world's population will be "left behind" while globalization carries a smaller number of more fortunate people to greater prosperity.

Furthermore, the rapid pace of economic change that offers promise to so many can simultaneously threaten things people around the world value, such as local cultures, the environment, or locally-owned businesses.

Chapter 15

Terminology

Imports	الواردات
Exports	الصادرات
Marginal Propensity to Import	الميل الحدى للواردات
Balance of Payment	ميزان المدفوعات
Balance of Trade	الميزان التجارى
Disposable Income .	الدخل المتاح
Expenditure Multiplier	مضاعف الإنفاق
Fixed Tax Multiplier	مضاعف الضريبة الثابتة
Proportional Tax Multiplier	مضاعف الضريبة النسبية
Balanced Budget Multiplier	مضاعف الميزانية المتوازنة
Planned and Realized Expenditure	الإنفاق المخطط والناتج المحقق

Marginal Propensity to Consume	الميل الحدى للاستهلاك
Marginal Propensity to Save	الميل الحدى للإدخار
Average Propensity to Consume	الميل المتوسط للاستهلاك
Average Propensity to Save	الميل المتوسط للادخار
Autonomous Consumption	الاستهلاك التلقائى
Induced Consumption	الاستهلاك التبعى
Multiplier	المضاعف
Saving Paradox	لغز الادخار
Autonomous Investment	الاستثمار التلقائى
Induced Investment	الاستثمار التبعى
Gross Domestic Product (GDP)	إجمالى الناتج المحلى والدخل المحلى
Gross Domestic Income (GDI)	إجمالى الدخل المحلى
Investment	الاستثمار

Capital Depreciation	اهتلاك رأس المال
Gross National Product	إجمالى الناتج القومى
Price Index	الأرقام القياسية للأسعار
Money Domestic Income	الدخل المحلى النقدى
Real Domestic Income	الدخل المحلى الحقيقى
Meaning of Economics	مفهوم علم الاقتصاد
Economic Problem	المشكلة الاقتصادية
Opportunity Cost	الفرصة البديلة
Macroeconomics	الاقتصاد التحليلى الكلى
Microeconomics	الاقتصاد التحليلى الجزئى
Hypothesis and Assumptions	الفرضية والافتراض
Aggregate Demand	الطلب الكلى
Aggregate Supply	العرض الكلى
Flow	التدفق

Stocks	الرصيد
Income and Wealth	الدخل والثروة
Marginal Propensity to Consume	الميل الحدى للاستهلاك
Price Elasticity	المرونة السعرية
Income Elasticity	المرونة الدخلية
Actua	المحقق
Aggregate consumption	إستهلاك كلى
Aggregate demand	طلب كلى
Aggregate demand function	دالة الطلب الكلى
Aggregate Saving	المدخلات الكلية
Aggregate supply function	دالة العرض الكلى
Aggregate supply	عرض كلى
Agricultural Economics	إقتصاد زراعى
Allocation of Foreign Exchange	تخصيص النقد الأجنبى

Allocation of shares	تخصيص الأسهم
Balance of invisible	ميزان التجارة غير المنظورة
Balance of payments deficit	عجز ميزان المدفوعات
Balanced Economic growth	نمو إقتصادى متوازن
Balance Economy	إقتصاد متوازن
Balance growth	نمو متوازن
Basic development sectors	قطاعات تدعيم النشاط الإقتصادى
Capital loss	خسارة رأسمالية
Capital movement	حركة رؤوس الأموال
Capitalist Economy	اقتصاد رأسمالى
Central market	سوق مركزى
Commodity development	تنمية المجتمع
Comprehensive plan	خطة شاملة
Continuous demand	الطلب المستمر

Gross national product (G.N.P)	الناتج القومى الإجمالى
Highest rate	أعلى معدل
Hoarding of cash balances	اكتناز الأرصدة النقدي
Human Capital	رأس المال البشرى
Hyper-inflation	التضخم الشديد /الجامح
Inflation	تضخم
Inflation Gab	فجوة تضخمية
Cost push Inflation	التضخم من جانب النفقات
Course of exchange	سعر الصرف
Creeping inflation	التضخم الزاحف
Crouding out	أثر المزاحمة
Cyclical Deficit	العجز الدورى
Cyclical unemployment	بطالة دورية
Deflation	انكماش
Demand-Pull Inflation	التضخم من جانب الطلب

Depreciation	إهلاك
Derived demand	طلب مشتق
Descriptive Economy	أسلوب وصفي
Direct economy	إقتصاد موجه
Disposable income	الدخل المتاح
Distributive shares method	طريقة الأنصبة
Econometrics	الإقتصاد القياسى
Economic analysis	تحليل إقتصادى
Economic crisis	أزمة إقتصادية
Economic depression	كساد إقتصادى
Economic development	تنمية إقتصادية
Economic growth	نمو إقتصادي
Economic indicators	مؤشرات إقتصادية
Economic situation	الوضع الاقتصادى
Economic system as a whole	النظام الاقتصادى
Economic welfare	الرفاهية الاقتصادية
Economics Depression	كساد إقتصادى
Economy	إقتصاد

Economy wide inflation	**تضخم الشامل**
Effective demand	**الطلب الفعال**
Employment	**التوظف**
Exportation	**التصدير**
Farm products	**منتجات زراعية**
Final sales method	**طريقة المبيعات النهائي**
Flat market	**سوق راكدة**
Frictional unemployment	**البطالة العرضية**
Full Employment	**التوظف الكامل**
Functions of money	**وظائف النقود**
General theory of employment ,Interest and Money	**النظرية العامة في العمالة والفائدة والنقود**
Investment demand curve	**منحنى طلب الاستثمار**
Investment multiplier	**مضاعف الاستثمار**
Isocosts curves	**منحنيات التكاليف المتكافئة**
Isoquants curves	**منحنيات الناتج المتكافئة**
Labor demand	**الطلب على العمالة**
Labor economics	**اقتصاديات العمل**

Labor market	سوق العمل
Labor supply	عرض العمل
Liquidity Trap	مصيدة السيولة
Macro economics	إقتصاد كلى
Marginal efficiency of capital	الكفاية الحدية لرأس المال
National expenditure	إنفاق قومى
National income	الدخل القومى
Natural Employment	التوظيف الطبيعى
Net Imports	صافى الواردات
Net output method	طريقة الناتج النهائى
Normative Economy	الاقتصاد الإقليمى
Planned	المخطط
Political economy	اقتصادى سياسى
Positive Economy	الاقتصاد الواقعى
Precautionary	دافع الإحتياط
Present value	القيمة الحالية
Permanent income	الدخل الدائم
Real of economic growth	معدل النمو الإقتصادى

Rate of exchange	سعر الصرف
Rate of growth	معدل النمو
Rate of return over cost	معدل العائد على التكاليف
Real Balance	الأرصدة الحقيقية
Real Exchange Rate	سعر الصرف الحقيقى
Real Money Supply	زيادة عرض النقود الحقيقية
Realized Investment	الاستثمار المحقق
Realized saving	الادخار المحقق
Replacement cost	تكلفة الإحلال
Sporadic inflation	التضخم الجزئى
Speculative motive	دافع المضاربة
The money illusion	الخداع النقدى
Theory of demand for money	نظرية الطلب على النقود
Transactions motive	دافع المعاملات
International Trade	تجارة دولية
Manufactures	سلع صناعية
Proportion	نسبة
Standard of Living	مستوى المعيشة

Specialization	تخصص في إنتاج سلعة معينة
Comparative Advantage	ميزة نسبية
Opportunity Cost	تكلفة الفرص البديلة
Criticisms	نقـد
Political Differences	خلافات سياسية
Arguments	مبررات
Economies of Scale	وفورات السعة – مزايا الإنتاج
Competition	منافسة
Efficiency	كفاءة
Protection	حماية
Customs Duties	جمارك
Specific Tariff	ضريبة محددة
Dumping	إغراق
Imposed	فرض
Inelastic Demand	طلب غير مرن
Inefficient Industries	صناعات عديمة الكفاءة
Terms of Trade	شروط التبادل
Qualifications	تحفظات

Transactions	**معاملات**
Record	**ســـجل**
Current Account	**الحساب الجاري**
Visible Trade	**الميزان التجاري**
Invisble Trade	**تجارة الخدمات غير المنظورة**
Private Transfers	**التحويلات الخاصة**
Capital Flows	**التدفقات الرأسمالية**
Hot Money	**استثمارات قصيرة الأجــل**
International Monetary	**صندوق النقد الدولي**
Gold Standard	**قاعدة الذهب**
Reserve Currency	**عملة الاحتياطي**
Spacial Drawing Rights	**حقوق السحب الخاصة**
Deflationary Inflation	**سياسة انكماشية**
Oversupply	**عرض زايد**
Liquidity Problem	**مشكلة السيولة**
Fixed Exchange Rates	**أسعار الصرف الثابتة**
Managed Flexibility	**مرونة في إدارة سعر الصرف**
Speculation	**مضاربة**

Unpopular Policies	سياسات غير تقليدية
Floatiing. Fluctuating or Free Exchange Rates	سعر الصرف المعوم أو المتغير
Expansionary	توسعي
Balance of Payments Surpluses or Deficits	الفائض / العجز في ميزان المدفوعات
Strike	إضراب عن العمل
Currency Devaluation	تحفيض سعر صرف العملة المحلية
Wealth	ثروة
Profit	ربح
Supply and Demand	العرض والطلب
Means	وسيلة
Firm	منشأة
Land	أرض
Labor	عمالة
Capital	رأس مال
Resource	مورد
Energy	طاقة
Good	سلعة

Service	خدمة
Product	منتج
Quality	نوعية
Decision	قرار
Outcome	نتيجة
Effective	فعال
Circular Flow	تدفق دائري
Choice	اختيار
Goals	أهداف
Preferences	تفضيلات
Household	أسرة
Inputs	مدخلات
Outputs	مخرجات
Market Mechanism	ميكانيكية السوق
Cartels	احتكارات
Workers Unions	نقابات العمال
Material Commodities	سلع مادية
Composite Good	سلعة مركبة

Market Structure	**هيكل السوق**
Transactors	**أطراف التعامل**
Common Stocks	**أسهم عادية**
Rate of Interest	**سعر الفائدة**
Tendency	**ميل**
Utility	**منفعة**
Marginal	**حدي**
Criterion	**معيار**
Maximum	**أقصـــــى**
Minimum	**أدنى**
Alternatives	**بدائل**
Equilibrium	**توازن**
Optimum	**أمثل**
Land	**الأرض**
Factors of Production	**عناصر الإنتاج**
Consumers	**مستهلكين**
Wants	**احتياجات**
Production Possibility Curves	**منحنى الإنتاج الممكن**

Cost	النفقات
Benefit	المنافع
Social Costs	التكاليف الاجتماعية
Money Costs	التكاليف النقدية
Marginal Costs	التكاليف الحدية
Average Costs	التكاليف المتوسطة
Total Costs	التكاليف الكلية
Fixed Costs	التكاليف الثابتة
Variable Costs	التكاليف المتغيرة
Risk	مخاطرة
Working Conditions	ظروف العمل
Rent	إيجـــــار
Wages	أجـــور
Population	سكان
Law of Diminishing Returns	قانون تناقص الغلة
Merit Goods	سلعة اجتماعية نافعة
De-Merit Goods	سلعة اجتماعية ضارة
Producer Goods	سلع رأسمالية

Consumer Goods	سلعة استهلاكية
Enterprise	مشروع (تنظيمي)
Scarcity	ندره
Free Good	سلع حرة

Questions

1. Define the following terminology:

- Government deficit - Inflation - unemployment - Factors of product - Money - Efficiency - Specialization - Total Cost-Price Index - Deflation - Balance of Payments - Protection Policy - Gross National product (GNP - Planned Economy - Privatization - Globalization - The Economic Problem - Opportunity Cost - Economic policy - Economic Growth - Embargo - Discrimination - Import Quotas - Exchange Rates - Official Financing - National Income - Economics Rent

2. Mention the difference between the following:

- Natural resources and human resources.
- Goods and services.
- capital goods and consumption goods.
- Social and commercial services.
- Profit and loss.
- Revenue and Expenditure.
- Direct and indirect taxes.
- Closed and open economics.
- Fixed and variable costs.
- Average and Marginal costs.

3. Differentiate between effectiveness and efficiency.

4. What are the basic economic concepts?

5. Explain how the output of the labor differs in both market economy and mixed economy?

6. What is meant by interdependence? And how International trade Increases interdependence?

7. Explain the roles of consumers, producers and citizens.

8. What is the Definition of Economy?

9. Why is Economy important?

10. What are the difference between Micro – and Macro economics?

11. There are various economic system. Explain two art of them?

12. What are the difference between needs and wants?

13. What is mean by "scarcity"?

14. What is mean by "production possibility Curves"?

15. Mention the difference between the public and private Sector?

16. What is mean by "Mixed Economy"?

17. Mention the difference between perfectly elastic demand and inelastic demand?

18. What are the main factors influencing elasticity of demand?

19. Mention the uses of Elasticity?

20. What is mean by "Income elasticity of demand"?

21. What is mean by "Wealth"?

22. how is capital accumulated?

23. What are the effects of Inflation on business?

24. What are the causes of Inflation?

25. Why dose the government collect taxations?

26. How do firms increase their profits?

27. What are the main factors of production?

28. What are the Advantages of Credit cards?

29. What are the cost of unemployment?

30. Mention the problems of measuring inflation?

31. What is meant by "Cost push"?

32. The prices of goods differ according to people, place and time. Explain?

33. What are the Functions of money?

34. Mention the characteristics of money?

35. Explain two forms of money?

36. What is meant by "Demand pull"?

37. What are the conditions factors of Demand?

38. What is meant by decrease in demand?

39. What are the conditions factors of supply?

40. What is the definition of Equilibrium?

41. Explain the effects of changes in the conditions of supply?

42. How can you measurement the price elasticity of demand?

43. What is meant by "Elasticity"?

44. Define productivity and mention its advantages?

45. What is the difference between money costs and capital costs?

46. What is mean by "Perfect Competition"?

47. What are the basic functions of money?

48. Explain in short the Quantity Theory of money?

49. What is sustainable Development?

50. Why do we need sustainable development?

51. Why do we Nations export and import?

52. Mention the advantages of trade specialization?

53. What are the difference between International Trade and International Economy?

54. What are the advantage of International Trade?

55. What are the Criticisms of the theory of Comparative Costs?

56. What are the method of protection?

57. What is mean by "Terms of trade"?

58. Mention the relationship between the terms of trade and balance of payments?

59. What are the advantages and disadvantages of the gold standard?

60. What are the advantages of floating exchange rates?

61. Is it good or bad to have a deficit or surplus on the balance of Payments? And How can it be eliminated?

62. Why is a balance of payments deficit considered to be undesinable?

63. How to cure a balance of payments surplus?

64. Define the difference between Market and effective rates of Interest?

65. Define: Wages, Earnings and Payrolls?

66. What are the difference between Money Wages and Real Wages?

67. What are the difference between the Economic Development and Economic growth?

68. What are the reasons for "Backwardness"?

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